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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 60

GROVER D. TURNBOW AND RUTH H. TURNBOW,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court (R. 29–42) is reported at 32 T.C. 646. The opinion of the court of appeals (R. 54–64) is reported at 286 F. 2d 669.

JURISDICTION

The judgment of the court of appeals was entered on December 5, 1960 (R. 65). The petition for a writ of certiorari was filed on March 2, 1961, and was granted on May 15, 1961 (R. 66). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Petitioner exchanged stock in one corporation for stock in another corporation plus cash in a transac-

tion that did not qualify as a "reorganization" as defined in § 112(g)(1) of the Internal Revenue Code of 1939. Section 112(b)(3) provides for nonrecognition of gain if, "in pursuance of [a] plan of reorganization," stock or securities are exchanged "solely for stock or securities * * * in another * * * party to the reorganization." Section 112(c)(1) provides that, if an exchange would be within § 112(b)(3) "if it were not for the fact that the property received in exchange consists not only of property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain, but also of other property," the gain will be recognized only to the extent of the "other property." The question is whether, notwithstanding that there was no reorganization, the fact that there would have been a reorganization (under § 112(g)(1)(B)) if petitioner had received the stock but not cash, entitles him, under § 112(c)(1), to have his gain recognized only to the extent of the cash. The specific questions of statutory interpretation on which that question turns are:

1. Whether, as used in § 112(c)(1), "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain" means "stock or securities in * * * a party to a reorganization" (§ 112(b)(3)) or also includes stock in a corporation not a party to a reorganization.

2. Whether the assumption that the "other property" was not received, made under § 112(c)(1) to determine whether the exchange "would be" within § 112(b)(3), may be utilized to satisfy not only the "solely" requirement of § 112(b)(3) but also the

requirements of a "reorganization" as defined in § 112(g)(1)(B).

STATUTE INVOLVED

Sections 112 and 113(a) (6) and (7) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.) are set forth in relevant part in the Appendix, *infra*. pp. 69–75.

STATEMENT

Petitioner[1] owned all of the outstanding stock (5,000 common shares) of the International Dairy Supply Company ("Supply"), a Nevada corporation engaged mainly in furnishing, under government contracts, reconstituted milk products for overseas use. In 1952, pursuant to an agreement,[2] he transferred all of the Supply stock to Foremost Dairies, Inc. ("Foremost"), a New York corporation engaged in processing and distributing dairy products. In exchange he received $3,000,000 in cash and 82,375 shares of Foremost common stock (a minority interest) having a fair market value of $1,235,625 ($15 per share). Petitioner's basis in the Supply stock was $50,000, and his expenses in connection with the transfer were $21,933.06. Accordingly, on the total receipts of $4,235,625, petitioner's gain was $4,163,691.94 (R. 25–27, 30–36).

In his income tax return for 1952, petitioner, treating the gain as recognizable only to the extent of the cash received, reported a long-term capital gain of

[1] Grover D. Turnbow will be referred to as the sole petitioner, his wife being a party only because a joint return was filed.

[2] The agreement also included another exchange of stock not involved here.

$2,984,992.77 ($3,000,000 less claimed expenses). The Commissioner determined that the entire gain was recognizable and asserted a deficiency (R. 35–36). The Tax Court held that the gain was recognizable only to the extent of the cash (R. 36–42). The court of appeals reversed, holding that the entire gain was recognizable (R. 54–64).

SUMMARY OF ARGUMENT

Petitioner, the sole stockholder of the Supply corporation, transferred all of his stock to the Foremost corporation in exchange for $3,000,000 in cash and Foremost voting stock worth $1,235,000. The question is whether his gain on the exchange ($4,163,000) is recognizable in full or only to the extent of the cash received. It is admittedly recognizable in full unless §§ 112(b)(3), 112(c)(1) and 112(g)(1)(B) of the Internal Revenue Code of 1939 operate to make part of the gain nonrecognizable.

Section 112(g)(1)(B), one of the six definitions of a "reorganization," defines a so-called "B" reorganization as:

> [§ 112(g)(1)] * * * (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 percentum of the * * * stock of another corporation * * *.

Petitioner admits that, while Foremost acquired more than 80% of the Supply stock, the transaction failed to qualify as a "B" reorganization because it did not give "solely * * * voting stock" in exchange, the

consideration given being over 70% in cash and less than 30% in voting stock.

Section 112(b)(3), the basic "nonrecognition" provision involved, prescribes the major consequence of a transaction's qualifying or not qualifying as a reorganization:

> [§ 112(b)(3)] *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Petitioner admits that his exchange was not within that provision, since it was neither incident to, nor were the stocks exchanged in parties to, a "reorganization." And since none of the property received consisted of "stock or securities *in* * * * *a party to a reorganization*," it did consist "solely" of such property.

That much being admitted, petitioner's argument cannot be, and is not, that the transaction *was* a reorganization; rather it is that it is not *necessary* to have a reorganization in order for an exchange of stock in one corporation for stock in another to be tax-free. That argument is based exclusively upon petitioner's construction of § 112(c)(1), the so-called "boot" provision, which provides:

> [§ 112(c)(1)] If an exchange would be within the provisions of * * * [§ 112(b)(3) or several other provisions] if it were not for the fact that the property received in exchange consists not only of property permitted by

> [§ 112(b)(3)] * * * to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

In the government's view, that provision is applicable only if some of the property received actually is "stock or securities in * * * a party to a reorganization" and some is not, so that the only reason the exchange failed to qualify under § 112(b)(3) was that the receipts did not consist "solely" of the permitted kind of property. It applies, in short, only if there is in fact a reorganization. We will show that that interpretation, adopted by the Ninth Circuit in this case, is required by the statute, the policy underlying it, its history, its relationship to cognate provisions, and the regulations interpreting it. The contrary decision of the Seventh Circuit in *Howard* v. *Commissioner*, universally criticized by tax commentators, is unsupportable.

1. The government's interpretation is required by the words of the statute. For purposes of determining its applicability, § 112(c)(1) divides the property received into two categories: (1) "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain"; and (2) "other property or money." The test to be applied is whether the exchange "would be" within § 112(b)(3) if only the property in the first category had been received. If so, the gain is recognized only to the extent of the property in the second category.

Since the division of the property actually received between the stated categories necessarily *precedes* the making of the hypothetical "would be" determination, that division must be made on the basis of the actual, not the hypothetical, facts. And if none of the property received can properly be placed in the first category, it is evident that § 112(c)(1) can have no application, for it is only to the extent of such property that it permits the nonrecognition of gain.

The crucial first step, therefore, is to determine which of the properties received fits into the first category: "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain." The answer here is that *none* of it does. The only property that § 112(b)(3) permits to be received without the recognition of gain is "stock or securities in * * * a party to a reorganization"—that is, not stock or securities in any corporation, but only those in one having a particular attribute, to wit, being a party to a reorganization. In this case, petitioner received, besides the obviously nonqualifying cash, only stock in a corporation (Foremost) that was *not* a party to a reorganization. That, on certain assumptions, it "would have been" is irrelevant, for the hypothetical "would be" test does not apply until *after* the categorization of the several properties received.

In short, the reason that § 112(c)(1) is inapplicable unless there is an actual reorganization is that, without one, none of the property received can qualify as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain."

2. Even accepting petitioner's unexplained assertion that the Foremost voting stock can, for purposes of § 112(c)(1), be treated as "permitted" property—and, hence, that the proper assumption to be made in applying the "but for" test is that he received the stock but not the cash—there is still a fatal defect in his argument. That error lies in petitioner's use of the no-cash assumption not only for purposes of determining whether § 112(b)(3) as such would apply (i.e., to overcome its "solely" requirement) but also for purposes of determining whether the transaction "would be" a reorganization under § 112(g)(1)(B).

Sections 112(b)(3) and (c)(1) deal only with individual "exchanges." Necessarily, therefore, the only assumption that § 112(c)(1) permits to be made is one about what the particular taxpayer received in the particular "exchange" in issue.

Section 112(g)(1)(B), on the other hand, is concerned, not with individual exchanges, but with the characterization of the entire planned transaction, which may, and typically does, involve numerous individual "exchanges." Specifically, the requirement of a "B" reorganization is, not that a particular stockholder receive solely voting stock for his shares, but that *all* of the stockholders participating in the "plan" receive solely voting stock. Thus, the assumption permitted by § 112(c)(1) (what a single stockholder received) has no logical relevance to the test of qualification as a "B" reorganization (what all the stockholders received).

It is essentially fortuitous in this case that, because petitioner happened to be a sole stockholder, what *he* received turns out to be identical with what the acquiring corporation gave, and petitioner acknowledges (by his reliance on *Howard,* which involved numerous stockholders) that the question of interpretation (how the § 112(c)(1) "assumption" is to be applied) cannot depend on that atypical circumstance. And in a case involving two (or more) stockholders, each of whom received some cash, the bar to using the § 112(c)(1) assumption to satisfy the reorganization definition (even hypothetically) would be plain: in determining the taxability of *each* stockholder's exchange (the only concern of § 112(c)(1)), the only assumption that could be made would be that *that* stockholder did not receive cash, and that would leave outstanding, as an independent bar to a "B" reorganization, the cash received by the *other* stockholders.

In short, the facts assumed under § 112(c)(1) are not relevant to the reorganization definitions (except fortuitously), and it therefore could not have been intended that the § 112(c)(1) assumption would be used to establish a hypothetical "reorganization." The assumption can properly be used only to satisfy the "solely" requirement of § 112(b)(3).

3. In every other of the several different kinds of exchanges to which § 112(c)(1) applies—e.g., exchanges of like-kind business property which fail to qualify under § 112(b)(1) because the exchange is not "solely" for the permitted kind of property—its function is limited to alleviating the "solely" re-

quirement of the basic nonrecognition provision. It would be anomalous to give it, in stock-for-stock exchanges, an effect totally different from its effect in all other exchanges.

4. That the "but for" clause of § 112(c)(1) does not permit hypothetical reorganizations to qualify is confirmed by the identical language of the "boot" provision applicable to corporations, § 112(d). For in that provision, the statement of the consequences of qualifying expressly assumes the existence of a reorganization (the consequences being made to depend upon whether the corporation distributes the boot "in pursuance of *the* plan of reorganization"), necessarily implying that only actual reorganizations could meet the test of qualification.

5. The reason that § 112(b)(3) and (c)(1) permit nonrecognition in an exchange of stock in one corporation for stock in another only if the two corporations are parties to a reorganization is evident. The policy of nonrecognition is that an exchange of "like-for-like" or a "mere change in the form of ownership" is not an appropriate event (not being sufficiently "closed") for the reckoning up of gain or loss. And the very function of the reorganization definitions is to prescribe when there exists a sufficient "continuity of interest" between two corporations to justify treating an exchange of their stocks as being a "mere change in the form of ownership." If that test if not satisfied (i.e., if there is no "reorganization"), the stocks exchanged are deemed to be no more "like" each other than the stocks of any other two unrelated corporations. There being no reorganiza-

tion in this case, the exchange, in policy terms, was not of "like-for-like-plus-boot" (as petitioner characterizes it) but of "unlike-for-unlike-plus-cash," the Foremost stock being as "unlike" the Supply stock as was the cash.

6. Petitioner's construction of § 112(c)(1) would, moreover, produce results inconsistent with the related basis provisions. Section 113(a)(7) gives corporations a "carryover" basis (i.e., the transferor's basis, appropriately adjusted for recognized gain or loss) for any property acquired "in connection with a reorganization," while in the absence of a reorganization the basis for any property acquired is "cost" (the fair market value of the property given in exchange) (§ 113(a)). The effect of those basis provisions is that the nonrecognition of the transferor's gain is obtained in a reorganization only at the price of the acquiring corporation having to take over the transferor's low basis for the property. Contrariwise, if there is no reorganization, the corporation acquires a "stepped-up" (fair market value) basis, but only at the price of the gain being recognized in full to the transferor. Petitioner's interpretation would destroy that relationship. Since the carryover basis provision would not be applicable, transactions failing to meet the solely-for-voting-stock requirement of the "B" definition would, in effect, be reorganizations *par excellence,* enjoying the best of both worlds (nonrecognition to the transferor *and* a "stepped-up" basis to the transferee). They would be treated "as though they were" reorganizations for

purposes of the desirable consequences of reorganizations (nonrecognition of gain) but as in fact not reorganizations for purposes of the undesirable consequences (carryover of basis). And since nonrecognition of gain and carryover of basis are the only two consequences of qualifying as a "B" reorganization, that preferential treatment would be the *only* consequence of failing to meet the solely-for-voting-stock requirement. The implication of petitioner's argument, in short, is that the reason Congress added the solely-for-voting-stock requirement to the reorganization definitions was to give *preferred* status to transactions that *failed* to meet it.

7. Petitioner's argument rests entirely upon the "but for" language of § 112(c)(1), to which he attributes a purpose, not only to alleviate the "solely" requirement of the several nonrecognition provisions, but also to extend nonrecognition to hypothetical reorganizations. The history of that provision shows that that was not, and could not have been, its purpose.

The original "boot" provision, in the Revenue Act of 1921, did not contain the "but for" language and provided simply that, if the property received consisted both of property "specified" in the nonrecognition provisions and of "other property", the gain should be recognized to the extent of the "other property," a directness of language that it was possible to employ because at that time the nonrecognition provisions did not contain the "solely" requirement. In the complete rewriting of those provisions in the Revenue Act of 1924, however, the basic nonrecogni-

tion provisions were all limited in terms to exchanges "solely" for the described kind of property. Since the presence of any other property would, under that wording, make the nonrecognition provisions altogether inapplicable, it was necessary to rephrase the "boot" provision to provide for *pro tanto* nonrecognition in exchanges that would have been within the basic provisions but for the failure to meet the newly-added "solely" requirement. The "boot" provision was, accordingly, rewritten in the "but for" form and it has remained unchanged ever since. The committee reports took no note of the change, except to refer to "minor changes in phraseology" in the nonrecognition provisions and to note that the "boot" provision of that Act "corresponds to [the equivalent section] of the existing law."

Not only, as that history shows, was the "but for" language not intended to have the effect petitioner attributes to it, but it *could not* have been so intended. The simple reason is that the solely-for-voting-stock requirement of the reorganization definitions (upon the interaction with which petitioner's interpretation of the "but for" language depends) was not then in existence and was, in fact, not added until ten years later. At the time of its adoption, the only purpose the "but for" language *could* have had was to alleviate the "solely" requirement of the basic nonrecognition provisions; there having been no intervening changes in that provision, that remains its only purpose today.

8. Final confirmation is provided by the Treasury Regulations, which explicitly adopt the interpretation of § 112(c)(1) urged here.

ARGUMENT

INTRODUCTION

Petitioner, the sole stockholder of the Supply corporation, transferred all of the Supply stock to the Foremost corporation in exchange for $3,000,000 in cash and Foremost voting stock worth $1,235,000. The court of appeals, upholding the Commissioner, held that the entire gain ($4,163,000, after expenses) was taxable. Petitioner contends that the gain should be recognized only to the extent of the $3,000,000 in cash received and should not be recognized to the extent that it is represented by the Foremost voting stock received on the exchange. The additional gain would, under petitioner's view, be recognized only when he ultimately disposes of the Foremost stock.

An exchange of property for other property is, of course, ordinarily a fully taxable event on which the entire gain must be recognized (§ 112(a)),[3] and a claim for nonrecognition must be based upon a specific statutory exception. The provisions upon which petitioner relies are § 112(g)(1)(B), one of the definitions of a "reorganization"; § 112(b)(3), making certain exchanges pursuant to a reorganization "tax-free" (i.e., providing for nonrecognition of gain or loss); and § 112(c)(1), governing the effect of the receipt of "boot" in exchanges that would otherwise be tax-free. It is upon the interpretation and interaction of those three provisions that the question in this case turns.

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[3] Unless otherwise indicated, all references are to the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.).

On the first step in the analysis, the Tax Court, the court of appeals, the petitioner, and the government are all agreed—namely, that the transaction between petitioner and Foremost whereby Foremost acquired all the stock of Supply did *not* qualify as a "reorganization" under § 112(g)(1)(B). A so-called "B" reorganization is defined by that section as:

> * * * (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 percentum of the * * * stock of another corporation * * *.

In this case, Foremost, the acquiring corporation, did acquire more than 80% of the stock of Supply (in fact, 100%), but it did not give "solely" Foremost voting stock in exchange, the total consideration being over 70% in cash and less than 30% in the form of voting stock. Thus the transaction patently, and admittedly, failed to qualify as a "reorganization" under the only revelant definition.

It is equally clear, and equally admitted, that petitioner's exchange of his Supply stock for Foremost stock and cash did not qualify as a tax-free exchange under § 112(b)(3), which provides:

> (3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

An exchange qualifies under that provision, it may be seen, only if:

(1) the exchange is incident to a reorganization;

(2) the taxpayer transfers stock or securities in a party to the reorganization;

(3) the taxpayer receives stock or securities in a party to the reorganization; and

(4) the property received consists "solely" of such stock or securities.

The exchange in this case met none of those four requirements. There being no "reorganization," the exchange was not incident to, and neither the Supply stock transferred nor the Foremost stock received was in a party to, a reorganization. And since petitioner received *no* "stock or securities in * * * a party to a reorganization," he obviously did not receive "solely" such stock or securities.

So much, as we have noted, is not in dispute. The dispute centers entirely upon the so-called "boot" provision, § 112(c)(1), which provides:

> (1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Petitioner contends that that provision makes his gain taxable only to the extent of the cash received notwithstanding that there was no reorganization and

the exchange met none of the requirements of § 112 (b)(3). The government contends, on the other hand, that the "boot" provision does not apply unless the first three requirements of § 112(b)(3) are independently satisfied (the exchange is incident to a reorganization and the taxpayer both gives and receives stock or securities in a party to the reorganization) and the only bar to qualification under § 112(b)(3) is the fact that the taxpayer received other property *in addition* to stock or securities in a party to the reorganization. In brief, the opposing interpretations of § 112(c)(1) are as follows:

In the government's view, § 112(c)(1) first divides the property received into two categories—(1) "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain"; and (2) "other property or money"—and then provides that, if the exchange "would be" within § 112(b)(3) if only the property in the first category had been received, the gain is to be recognized only to the extent of the property in the second category. If that is a proper reading, the provision cannot apply unless *some* of the property received in fact belongs to the first category. In turn, the only property that § 112(b)(3) "permits" to be received without the recognition of gain (the first category) is, in express terms, "stock or securities in * * * a party to a reorganization". It follows that *none* of the property received can qualify in the first category unless there is in fact a "reorganization." In this case Foremost was not a party to a reorganization. Therefore the Foremost voting stock does not qualify for the first category any better than

the cash. Rather all of the property received belonged to the second category, "other property or money," and the second step—whether the exchange "would be" within § 112(b)(3) if only the property in the first category had been received—is never reached.

Petitioner contends, on the other hand, that the Foremost voting stock, though not stock in a party to a reorganization, belongs nevertheless to the first category, "property permitted by [§ 112(b)(3] * * * to be received without the recognition of gain," and only the cash belongs to the second. The test, in his view, then becomes whether the exchange "would be" within § 112(b)(3) if he had received the *stock* but not the *cash*. He then contends that the assumption to be made in applying that test—that no cash was received—may be utilized not only to satisfy the "solely" requirement of § 112(b)(3) but also the requirements of a "reorganization" under § 112(g)(1)(B) (a step with which the government also disagrees). On those premises, petitioner reasons that "but for" the cash there would have been a reorganization under § 112(g)(1)(B) and the exchange would therefore have been within § 112(b)(3), thereby meeting the "but for" test of § 112(c)(1) and entitling him to have his gain recognized only to the extent of the "other property" (which, in his view, consists only of the cash).

The petitioner's interpretation of § 112(c)(1) as permitting a tax-free exchange of stock in one corporation for stock in another without there being a "reorganization" was that adopted by the Seventh Cir-

cuit in *Howard* v. *Commissioner*, 238 F. 2d 943, a decision that has been universally criticized by tax commentators[4] and prompted recommendations of corrective legislation from professional advisory groups.[5] The government's interpretation is that

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[4] See e.g., 3 Mertens, *Law of Federal Income Taxation* (Rev.), Sec. 20.147, fn. 84a; Surrey and Warren, *Federal Income Taxation* (1960 ed.) 1551-2; Rabkin and Johnson, *Federal Income Gift and Estate Taxation*, 3803; Bittker, *Federal Income Taxation of Corporations and Shareholders*, 387-388; Darrell, *The Use of Reorganization Techniques in Corporate Acquisitions*, 70 Harv. L. Rev. 1183, 1207, 1232 (1956-57); Donnelly, *Courts Wrongly Permit Boot in Old-Law Reorganizations*, 11 Journal of Taxation 138; (September, 1959); Leake, *Problems in Corporate Acquisitions*, 13 Tax Law Review 67, 74, 77; Kanter, *The Changing Complexion of the "B" Reorganization*, 45 A.B.A.J. 1317 (1959); Note, *Reorganizations—(B) Reorganization Exists Though Boot is Received*, 73 Harv. L. Rev. 1402 (1959-60); Note, *Recognition of Gain Limited to Cash Received Which Barred Reorganization Characterization*, 57 Columbia L. Rev. 591 (1957); McDonald and Willard, *Tax Free Acquisitions and Distributions*, 14 N.Y.U. Institute on Federal Taxation 859 (1956); Kanter, *C.A.-9 says boot makes B reorganization impossible; Turnbow conflicts with C.A.-7*, 14 Journal of Taxation, No. 4, p. 222, (April 1961); Merritt, *Tax-Free Corporate Acquisitions*, 53 Mich. L. Rev. 911 (1954-55); Comment, *Application of Boot Provisions to an Attempted (B) Reorganization*, 3 U.C.L.A. Law Rev. 415 (1961); cf. Note, *Taxation Shareholders Receiving only Stock Recognize no Gain in What Would Have Been a "B" Reorganization Except for the Presence of Boot*, 43 Va. L. Rev. 436 (1957).

[5] See *Revised Report of the Advisory Group on Subchapter C of the Internal Revenue Code of 1954 to accompany H. Rep. 4459*, 86th Cong., 1st Sess., pp. 66, 77, criticizing the *Howard* decision and recommending an amendment to the "boot" provision "to make clear that it operates only in a transaction which, independent of its provisions, qualifies as a reorganization." The American Bar Association has endorsed the ad-

adopted by the Ninth Circuit in this case. It was to resolve the conflict between those two decisions, on a question of basic and continuing importance to the scope of the reorganization and nonrecognition provisions,[6] that the case was brought here.

I

SECTION 112(C)(1) LITERALLY APPLIES ONLY IF SOME PART OF THE PROPERTY RECEIVED IS ACTUALLY, NOT HYPOTHETICALLY, OF THE KIND DESCRIBED IN THE UNDERLYING NONRECOGNITION PROVISION, WHICH IN THE CASE OF SECTION 112(B)(3) REQUIRES THAT THERE BE AN ACTUAL, NOT A HYPOTHETICAL, REORGANIZATION

In every other of the several different kinds of exchanges to which § 112(c)(1) applies—e.g., exchanges of like-kind business property which fail to qualify under § 112(b)(1) because the exchange is not "solely" for the permitted kind of property—its function, as we will later demonstrate (see Point III, *infra*), is necessarily limited to alleviating the "solely" requirement of the basic nonrecognition provision. We will show that, properly interpreted, its function is similarly limited in stock-for-stock exchanges—i.e., that it applies only when there *is* a reorganization and the taxpayer *does* receive "stock

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visory committee's recommendation, urging that the amendment was "advisable for the sake of certainty in view of the language of *Howard* * * *, which implied the contrary, despite the generally held view that the rule established by this proposed amendment was already applicable" (106 Cong. Rec. p. A1462 (Daily Issue, Feb. 23, 1960)).

[6] Although this case is governed directly by the 1939 Code, petitioner's argument would be equally applicable under the 1954 Code. See §§ 354(a)(1), 356(a)(1), and 368(a)(1)(B) of the 1954 Code.

or securities in * * * a party to the reorganization" but *also* receives other property. Such an exchange—which could readily occur in several different kinds of reorganizations[7]—would fail to qualify under § 112(b)(3) because it was not "solely" for the permitted kind of property. The "boot" provision, however, alleviates the "solely" requirement by providing that, if the exchange would have been within § 112(b)(3) but for the fact that other property was received in addition to the permitted property, the gain

[7] The most common type would be a "statutory merger or consolidation" qualifying as an "A" reorganization, but the "D", "E", and "F" definitions likewise contain no specific limitation on the kind of property that may be transferred. See § 112(g)(1), *infra*, p. 72. It cannot be said with certainty, for that matter, that there could not be "other property" in a transaction qualifying as a "B" or "C" reorganization. While those definitions do literally require that "solely * * * voting stock" be given, that requirement raises questions of interpretation (not involved in this case) that have not yet been finally resolved. For example, since § 112(g)(1)(B) requires only that 80% of the stock of another corporation be acquired, it is arguable that that definition is met if the consideration allocable to at least 80% of the stock consists of voting stock, notwithstanding that the acquiring corporation also acquires additional shares (e.g., from dissenting stockholders) for money or other property. That was in fact the situation in the *Howard* case, in which the acquiring corporation gave solely voting stock for 81% of the shares but gave cash to a dissenting minority for the remaining 19%. While the Seventh Circuit held that the cash given the minority precluded a "B" reorganization, the question is a debatable one and there is no assurance that other courts would follow that decision. In this case, of course, since less than 30% of the consideration was in the form of voting stock, that question is not raised. The question involved here goes rather to the second holding in the *Howard* case—namely, that the exchanges were tax-free despite the court's holding that there was *not* a reorganization.

is to be recognized only to the extent of the "other property." What we propose to prove is that that is the *only* function of § 112(c)(1) and that it does not do double service by alleviating not only the "solely" requirement of § 112(b)(3) but also the requirements of a "reorganization" under § 112(g)(1)(B).

1. Limited to its interaction with § 112(b)(3), § 112(c)(1) provides:

> (1) If an exchange would be within [§ 112(b)(3)] * * * if it were not for the fact that the property received in exchange consists not only of property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

In order to separate the steps involved in applying that provision, it can, we think, fairly be restated in this manner:

> (A) If there is received in an exchange both:
> (i) "property permitted by [§ 112(b)(3] * * * to be received without the recognition of gain" and
> (ii) "other property or money"; and
> (B) if the exchange "would be" within § 112(b)(3) if only the property in the first category had been received; then
> (C) the gain shall be recognized only to the extent of the property in the second category.

That restatement makes clear that the crucial first step is the division of the property received between the

two stated categories: (i) "permitted" property; and (ii) "other" property. Unless *some* of the property received comes within the first category, § 112(c)(1) can have no application, for it is only to the extent of such property that it permits the nonrecognition of gain. That requirement, moreover, must be actually, not hypothetically, satisfied. It is only after it appears that some of the property belongs to the first category that one reaches the hypothetical question—namely, whether the exchange would be within § 112(b)(3) if only that property had been received.

The first question of interpretation, therefore, is what is meant by "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain". What it means, we suggest, is clear beyond doubt, for § 112(b)(3) describes in express terms what property it "permits" to be received without the recognition of gain—namely, "stock or securities in * * * a party to a reorganization." It is not "stock" in any corporation, but only stock in a corporation having a particular attribute—i.e., being a party to a reorganization—that § 112(b)(3) "permits" to be received without the recognition of gain.[8]

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[8] Obviously, for example, if in an exchange incident to the merger of the *X* and *Y* corporations (an "A" reorganization), a stockholder of *X* received, in exchange for his stock, property consisting of *Y* stock, cash, and some General Motors stock that *Y* happened to own, the only part of the receipts that would qualify as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain" would be the *Y* stock. The General Motors stock, though "stock", would not be stock "in * * * a party to the reorganization", and would have to be placed, like the cash, in the second category, "other property or money." Plainly, then, "in * * * a party to a reorganization"

Since there must be some property belonging to the first category that § 112(c)(1) establishes—"property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain"—for that section to be applicable; and since the only property meeting that description is "stock or securities in * * * a party to a reorganization"; it follows that § 112(c)(1) does not apply unless the taxpayer actually, not hypothetically, receives some "stock or securities in * * * a party to a reorganization." Without that predicate being established, the hypothetical question—would the exchange be within § 112(b)(3) if only the property so qualifying had been received—is never reached. In short, § 112(c)(1), no less than § 112(b)(3), is inapplicable unless there is in fact a "reorganization."

2. In this case, there was admittedly no reorganization. Foremost was therefore not a "party to a reorganization", and its stock was not "stock * * * in * * * a party to a reorganization." Thus none of the property petitioner received, neither the cash nor the Foremost stock, was "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain." It was *all* "other property." Plainly § 112(b)(3) can have no application and petitioner's gain was therefore recognizable in full.

The explanation of the apparent plausibility of petitioner's argument is that it ignores that crucial first step in the application of § 112(b)(3). It starts with

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is an essential part of the description of the *kind* of property qualifying, for purposes of § 112(c)(1), as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain."

the second step, the hypothetical question, and in stating that question simply assumes that "voting stock of Foremost" qualifies as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain. Thus, at the very opening of his argument (Br. 9), petitioner states the question as being whether the exchange would have been within § 112(b)(3) "'if it were not for the fact that' the property received in exchange consisted not only of [i] voting stock of Foremost but also of [ii] money." Petitioner's whole case, we submit, lies in that unheralded and unexplained substitution of "voting stock of Foremost" in the place of the statutory phrase, "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain". And the answer to his case is that "voting stock of Foremost" in fact does *not* qualify as "permitted" property, but belongs rather to the second category, "other property or money."[9]

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[9] Petitioner's treatment of the Foremost voting stock as being the "permitted" property and of the cash as being the "other property" is made even colorable only by the circumstance that § 112(b)(3) at least mentions "stock" (albeit stock in "a party to a reorganization") while it does not refer at all to "money." Even that superficial basis for allocation would disappear, however, with the case being no different, had he received *nonvoting* stock instead of the cash. While that would equally have precluded a "B" reorganization (which requires solely *voting* stock), there is nothing in § 112(b)(3) (which lumps together all "stock or securities in * * * a party to a reorganization") or § 112(c)(1) which suggests the slightest possible distinction between different kinds of stock in the same corporation. The voting and the nonvoting stock would be *equally* close to being "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain." If one qualified,

Although petitioner's brief does not address itself to the question, his unstated premise seems to be that "voting stock of Foremost" can be placed in the "permitted" category because it "would have been" permitted property if nothing else had been received. But it is not at that step that the "hypothetical" determination is to be made. The only hypothetical step is in determining whether the exchange would have been within § 112(b)(3) if only the "permitted" property and not the "other property" had been received. Necessarily, the division of the property between the "permitted" property and the "other property" must be made before that step is reached.

To put the point another way, petitioner seeks to have § 112(c)(1) do double service. First, he wants it hypothetically to convert a transaction that was not a reorganization into a reorganization so that some of the property he receives will qualify as "property permitted by [§ 112(b)(3)] * * * to be received with-

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even hypothetically, as "stock * * * in * * * a party to a reorganization", so must the other, since it is equally "stock" and is in the same corporation. In such a case, surely, the receipts would have have to be treated either as *all* "permitted" property (which they obviously could not be, or there would be no need to resort to the "boot" provision) or as *all* "other" property (in which event, resort to the "boot" provision would be fruitless). The point of the supposed case is that, there being no distinction at all between two kinds of stock for purposes of §§ 112(b)(3) and (c)(1), it makes obvious the fact, equally true here, that without a reorganization *none* of the property received can qualify under § 112(c)(1) as "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain."

out the recognition of gain." Second, he wants it to allow the "permitted" part of the property to be received tax-free as if the "other" property was not received. Section 112(c)(1) permits the second hypothesis—i.e., to assume that the "other property" was not received in order to satisfy the "solely" requirement of § 112(b)(3). It does not permit one to assume a hypothetical reorganization so as to satisfy the requirement that some of the property received be of the kind permitted by § 112(b)(3) to be received without the recognition of gain—i.e., to satisfy the "reorganization" requirement of § 112(b)(3).

From the terms of § 112(c)(1) itself, therefore, it is plain that it becomes operative only when some of the property received is of the kind described in the underlying nonrecognition provision and some is not. Its meaning, and only meaning, is that if the property received consists in part of qualifying property (i.e., that described in the underlying provision) and in part of nonqualifying property, and the other requirements of the nonrecognition provision are met, the qualifying property may be received "tax-free" and the gain will be taxed only to the extent of the nonqualifying property. It neither adds to nor detracts from the qualification of property as the *kind* of property permitted to be received without the recognition of gain by the underlying nonrecognition provision; it only preserves that qualification notwithstanding the presence of additional, nonqualifying, property. None of the property received in this case having qualified as the kind permitted by § 112

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(b)(3) to be received without the recognition of gain, the "boot" provision is irrelevant.

II

AN INDEPENDENT REASON WHY SECTION 112(C)(1) CANNOT BE MADE USE OF TO ESTABLISH A HYPOTHETICAL REORGANIZATION IS THAT THE ASSUMPTION THAT A PARTICULAR STOCKHOLDER DID NOT RECEIVE "OTHER PROPERTY" IN A PARTICULAR EXCHANGE IS LOGICALLY IRRELEVANT TO QUALIFICATION OF THE TRANSACTION AS A WHOLE, NORMALLY INVOLVING MANY EXCHANGES, AS A REORGANIZATION

There is a second error in petitioner's argument which, while less obvious than that discussed in the first point, is no less fundamental. To demonstrate that, we will accept petitioner's statement of the test as being whether the exchange would have been within § 112(b)(3) but for the fact that petitioner received not only Foremost voting stock but also cash. That is, we will accept petitioner's premise that, in determining hypothetical qualification of the exchange under § 112(b)(3), it is proper to assume that he received solely the voting stock and no cash. Even so, we submit, the method employed by petitioner in applying that test (i.e., in making the hypothetical determination) is improper.

Petitioner contends that the assumption made under § 112(c)(1) can be utilized, not only to satisfy the "solely" requirement of § 112(b)(3), but also to establish a hypothetical reorganization under § 112(g)(1)(B) and thereby satisfy the "reorganization" requirements of § 112(b)(3). He reasons that if only voting stock had been received the transaction "would have been" a reorganization under § 112(g)(1)(B) (acquisition by one corporation (Foremost), in ex-

change "solely" for its voting stock, of more than 80% of the stock of another corporation (Supply)); and hence the exchange would have been pursuant to, and involved stock in parties to, a "reorganization," thereby satisfying § 112(b)(3). It is our position, to the contrary, that the assumption made under § 112 (c)(1) cannot be utilized to satisfy, even hypothetically, the requirements of a "reorganization" under § 112(g)(1)(B) and that its function is limited to satisfying the "solely" requirement of § 112(b)(3) itself.

The reason that is so is that §§ 112(b)(3) and (c)(1), on the one hand, and § 112(g)(1)(B), on the other, are concerned with transactions of an entirely different scope, and the assumptions made for purposes of the former have no logical relevance to the latter. Although one of their requirements is that the particular exchange be "pursuant to" an over-all plan, §§ 112(b)(3) and (c)(1) apply only to individual exchanges—i.e., they specify the tax consequences of each exchange pursuant to the over-all plan. Any assumption that § 112(c)(1) permits to be made is therefore necessarily limited to an assumption about what was received by the single recipient in the particular "exchange" in issue. Section 112(g)(1)(B), on the other hand, is concerned with the characterization of the "plan" as a whole, which may, and usually does, consist of many individual "exchanges"; qualification under it depends, not upon what a particular participant receives, but upon what all of the participants receive—or, even more precisely, upon what the acquiring corporation gives to all the par-

ticipants (which must be solely voting stock). Hence the fact assumed under § 112(c)(1) (what a single participant received) is logically irrelevant to qualification as a reorganization under § 112(g)(1)(B) (which turns upon what all the participants received).

The significance of that distinction is obscured in this case by the fortuitous, and atypical, fact that, since petitioner alone owned all of the Supply stock, the entire "plan" consisted of but a single "exchange" and what petitioner received and what Foremost gave turn out to be identical. Since petitioner's argument is not limited to such a unique case,[10] however, we can, to demonstrate the importance of that distinction, properly assume a transaction, otherwise identical to this case, involving two equal shareholders, *X* and *Y*, each of whom received in exchange for his stock precisely half of what petitioner received (i.e., 30% in Foremost voting stock and 70% in cash).

Under petitioner's statement of the test, whether the gain taxable to *X* is to be limited under § 112(c)(1) to the cash he received depends upon whether his "exchange" would be within § 112(b)(3) if it were not for the fact that "the property received in exchange consisted not only of voting stock of Foremost but also of money." The answer, clearly, is that it would not be. The only assumption that test permits to be made is that *X* (the party to

[10] Witness his reliance on *Howard*, which involved numerous stockholders.

the "exchange") received no cash, and that assumption still leaves outstanding the cash received by *Y*, which by itself is sufficient to prevent the transaction from qualifying as a "reorganization" under § 112(g)(1)(B) (which requires that *all* of the participants receive solely voting stock). In short, even if we assume that *X* received no cash, the fact that *Y* received cash still prevents *X*'s exchange from qualifying, even hypothetically, under § 112(b)(3). Needless to say, the same would be true of *Y*'s exchange, since in applying § 112(c)(1) to his exchange, the cash received by *X* would be the barrier.

Thus to give § 112(c)(1) the effect petitioner attributes to it, in any case involving more than one stockholder, requires not only the unexplained substitution of "voting stock in a corporation not a party to a reorganization" for the statutory phrase, "property permitted by [§ 112(b)(3)] * * * to be received without the recognition of gain" (discussed in Point I), but also a still further distortion so that it would read:

> If an exchange would be within [§ 112(b)(3)] * * * if it were not for the fact that the property received in exchange [not only in that exchange but in all other exchanges pursuant to a common plan] consists not only of [voting stock in a corporation not a party to a reorganization] but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and

> the fair market value of such other property [to the extent that such money or property is received by him].[11]

That is, indeed, precisely the effect of the Seventh Circuit's application of § 112(c)(1) in the *Howard* case, where the particular taxpayers involved had in fact received *solely* voting stock and § 112(c)(1) was utilized exclusively for the purpose of assuming away the cash received by *other* stockholders. It is also, in the end, the interpretation for which petitioner contends, for he is understandably unwilling to claim an interpretation that would forego *Howard* and which would be applicable only in the case where a single stockholder happens to receive all of the disqualifying cash.[12]

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[11] Having expanded the "other property or money" to include that received by all the participants, the last qualification must be added to prevent the cash received by other participants from being taxed to "the recipient" in the single "exchange" to which § 112(c)(1) is being applied.

[12] The absurdity of such a distinction can be demonstrated by a case involving two stockholders, in which *X* receives solely voting stock and *Y* receives both voting stock and cash. If § 112(c)(1) permitted a taxpayer to assume away his own cash for purposes of showing a hypothetical "B" reorganization but not the cash received by others, it would produce the bizarre result that *X*, who received solely stock, would be fully taxed (since he could not assume away *Y*'s cash), while *Y* would be entitled to nonrecognition to the extent of the stock he received (since he could assume away his own cash). In short, if the no-boot assumption can be utilized to create a hypothetical "reorganization" (and not simply to satisfy the "solely" requirement of § 112(b)(3)), the assumption cannot rationally be limited to the "boot" received by the particular taxpayer but must be extended to assume away the "boot" in all the exchanges pursuant to a common plan. Otherwise, the single stockholder who received all the "boot" would be preferred over those who received none.

III

IN EVERY OTHER OF ITS SEVERAL APPLICATIONS, SECTION 112(c)(1), WHILE ALLEVIATING THE "SOLELY" REQUIREMENTS OF THE VARIOUS NONRECOGNITION PROVISIONS, ACCORDS NONRECOGNITION ONLY TO THE RECEIPT OF PROPERTY INDEPENDENTLY QUALIFYING AS THE KIND OF PROPERTY DESCRIBED IN THE BASIC PROVISION, AND IT WOULD BE ANOMALOUS TO GIVE IT AN ENTIRELY DIFFERENT EFFECT IN ITS APPLICATION TO STOCK-FOR-STOCK EXCHANGES

We have thus far shown that, in its interaction with § 112(b)(3), the only function § 112(c)(1) performs is to alleviate the requirement that the exchange be "solely" for the kind of property described in § 112(b)(3); it does not make tax-free the receipt of any property that does not independently qualify as the kind of property permitted by that provision to be received without the recognition of gain (i.e., "stock or securities in * * * a party to a reorganization"). To confirm that interpretation, we will show that that is also, and even more obviously, the only function it has in its several other applications.

Section 112(b)(3) (exchanges of stock for stock incident to a reorganization) is, of course, only one of several provisions providing for nonrecognition of gain or loss in various kinds of exchanges, and § 112(c)(1) serves as the "boot" provision for all of them (with one exception to be noted later, see Point IV). The other provisions to which it applies provide for nonrecognition of gain or loss in the following kinds of exchanges:

> § 112(b)(1): exchange of business or investment property "solely" for business or investment property "of a like kind."
>
> § 112(b)(2): exchange of stock "solely" for stock in the same corporation.

§ 112(b)(5): transfer of property to a controlled corporation in exchange "solely" for stock or securities of that corporation.

§ 112(l): exchange of stock or securities "solely" for stock or securities of a successor corporation pursuant to a court-approved plan in insolvency (e.g., Chapter X) proceedings.

Since each of those provisions, like § 112(b)(3), contains the "solely" requirement, an exchange in which the property received consisted in part of the kind of property described in the relevant provision (e.g., like-kind business property, in the case of § 112(b)(1)) and in part of other property would fail to qualify and, if it were not for the "boot" provision, the entire gain would be recognized. Section 112(c)(1) avoids that result, providing that in such a case the gain will be recognized only to the extent of the other property.

In each of those applications, the only function that § 112(c)(1) performs is to alleviate the requirement that the exchange be "solely" for the described kind of property. It does not alleviate the requirement that the part of the receipts claimed to be "tax-free"[13] be the kind of property described in the

[13] As used in this context, "tax-free" implies only that the gain is not recognized to the extent that it is attributable to that part of the receipts. The property that is said to be received "tax-free" enters into the computation of the gain, but the gain is "recognized" (i.e., taxed) only to the extent of the "other property." If there is no "other property," then of course the gain is not recognized at all. That ultimately is the only difference between an exchange qualifying under a basic nonrecognition provision (e.g., § 112(b)(3)) and one qualifying under the "boot" provision, and in common parlance

underlying nonrecognition provision. If, for example, business property were exchanged for other business property plus cash, § 112(c)(1) would operate to postpone recognition of any part of the gain only if the business property received independently met the description in § 112(b)(1) of the *kind* of property that may be received tax-free (namely, business property "of a like kind"). If the business property received were not "of a like kind" within the meaning of § 112(b)(1), the "boot" provision would be of no avail.

The important point to observe is that in the application of § 112(c)(1) to, say, a § 112(b)(1) type of exchange—and the same is true of its application to § 112 (b)(2), (b)(5), and (l) exchanges—there is not involved a hypothetical determination of what "would be" like-kind property if the facts were different. Part of the property received must *actually* be "of a like kind"—or be stock of the same corporation, or stock of a controlled corporation, or stock of a corporation emerging from Chapter X proceedings—and only if it is, does the "boot" provision permit nonrecognition even in part.

Under our interpretation of § 112(c)(1) as applying to stock-for-stock exchanges only if there is a "reorganization," its function in such exchanges is precisely the same as in every other kind. The typical case is a merger qualifying as a "reorganization" under § 112(g)(1)(A) in which a stockholder of the

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they are equally referred to as "tax-free" exchanges, the caveat that the gain is recognizable to the extent of the "boot," if any, being implicit.

merged corporation receives stock in the surviving corporation plus cash. The stock received is "stock * * * in * * * a party to the reorganization" within the meaning of § 112(b)(3), but the exchange does not qualify under that provision since the property received does not consist "solely" of such stock. The "boot" provision applies, however, and makes the gain taxable only to the extent of the non-qualifying property—i.e., the cash. Here again the only effect of § 112(c)(1) is to overcome the "solely" requirement of the underlying nonrecognition provision. It operates to permit the property of the kind that § 112(b)(3) permits to be received tax-free to continue to be received tax-free notwithstanding the presence of the other property, while taxing the other property. There is exempted from tax only the property which actually meets the § 112(b)(3) description, not property which hypothetically "would" meet that description if the facts were different.

Our interpretation, then, gives to the "boot" provision in all of its applications—whether in interaction with subsection (b)(1), (b)(2), (b)(3), (b)(5), or (l)—a uniform, simple, and straightforward function. It does no more than provide that if *some but not all* of the property received is of the kind described in the relevant nonrecognition provision the gain will be recognized only to the extent of the nonqualifying property. It does not make something into a reorganization when it is not.

The effect petitioner would attribute to the "boot" provision in this case is, on the other hand, of an

entirely different order from its effect in every other case. For in this case not only did the property received by petitioner not consist "solely" of property of the kind described in § 112(b)(3) ("stock or securities in * * * a party to a reorganization") but, as we have seen, it did not consist at all of such property. Thus petitioner is relying on the "boot" provision not only to alleviate the "solely" requirement of the underlying nonrecognition provision—its only function in every other application—but for a second and entirely different function: namely, to extend tax-free treatment to property not of the kind described in the basic nonrecognition provision. In every other application, the "boot" provision operates to "save" property independently qualifying under the nonrecognition provision from losing its tax-free status because other property is also received; here it is claimed to confer tax-free status upon property which meets no part of the description of tax-free receipts in the underlying provision. It is at least unlikely, we suggest, that the "boot" provision was intended to have in one particular application a result so markedly different in kind from its effect in all other applications.

IV

THE COMPANION "BOOT" PROVISION GOVERNING ASSETS-FOR-STOCK EXCHANGES EMPLOYS THE SAME LANGUAGE AS SECTION 112(c)(1) BUT MAKES EXPRESS THE ASSUMPTION THAT ONLY "REORGANIZATION" EXCHANGES CAN QUALIFY, THUS CONFIRMING THAT INTERPRETATION OF SECTION 112(c)(1)

Under our interpretation §§ 112(b)(3) and 112(c)(1) make a reorganization prerequisite to the nonrecognition of gain (whether in whole or in part) in

stock-for-stock exchanges. That interpretation is confirmed by the companion provisions governing assets-for-stock exchanges by corporations (§§ 112(b)(4) and 112(d)) which, while otherwise identical to §§ 112(b)(3) and 112(c)(1), make express the assumption that only in reorganization exchanges can their requirements be met. Petitioner's interpretation makes these related sections essentially inconsistent.

The basic nonrecognition provision governing assets-for-stock exchanges is § 112(b)(4), which provides:

> No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

That provision, it may be seen, is in all respects parallel to § 112(b)(3) (governing stock-for-stock exchanges), the only difference being in the property the taxpayer transfers in the exchange.

The "boot" provision applicable to such exchanges is § 112(d), which provides:

> If an exchange would be within the provisions of subsection (b)(4) * * * if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—
>
> (1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the

> corporation shall be recognized from the exchange, but
>
> (2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

It is apparent that the "if" clause of § 112(d) is substantially identical to that of § 112(c)(1) (the "boot" provision involved in this case). The only difference appears in the "then" clause. That is to say, the test of qualification is identically stated in the two provisions, and the only difference is in the clauses prescribing the consequences of qualifying.

It is equally evident, however, that the provisions governing the consequences of qualifying under § 112(d) expressly assume the existence of a "reorganization." Two alternative consequences are stated, and which is applicable depends solely upon whether or not the corporation "receiving such other property or money distributes it *in pursuance of the plan of reorganization.*" Since there can be no "plan of reorganization" unless there is a "reorganization," the necessary assumption is that no exchange could qualify under the test stated in § 112(d) (the "if" clause) that was not incident to a reorganization. That assumption is true, in turn, only if the reference in the "if" clause to property "permitted by such paragraph [here, § 112(b)(4)] to be received without the recognition of gain" requires, as we contend that

it does, that some of the property received be in fact (not hypothetically) "stock or securities in * * * a party to a reorganization"—in short, that there be an actual reorganization.

If the test stated in § 112(d) in its application to § 112(b)(4)-type exchanges can be satisfied only if there is an actual reorganization—as § 112(d), in its statement of consequences, clearly assumes—then this must also be true of the test stated in § 112(c)(1) in its application to § 112(b)(3)-type exchanges, for the relevant language of both the underlying provision and of the "boot" provision is identical in both cases.[14] Section 112(d), therefore, directly confirms

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[14] Not only is the language identical, but the question of interpretation of § 112(d) could arise in circumstances precisely parallel to those of this case. Section 112(g)(1)(C) (which is parallel to § 112(g)(1)(B), the reorganization definition involved in this case) defines as a reorganization the acquisition by one corporation, in exchange "solely" for its voting stock, of substantially all the assets of another corporation (i.e., an assets, rather than a stock, acquisition, as is involved here). Suppose the *X* corporation, in a transaction that did not meet any of the other definitions of a reorganization, acquired all the assets of the *Y* corporation but gave in exchange both voting stock and cash. Notwithstanding the failure of the transaction (because of the cash) to qualify as a "C" reorganization, the *Y* corporation could claim that its exchange was taxable only to the extent of the cash received under § 112(d) on precisely the same argument that petitioner makes in this case—i.e., the transaction "would have been" a reorganization, and the exchange "would have been" within § 112(b)(4), if it were not for the cash. Thus petitioner's interpretation of the "if" clause would mean that a non-reorganization exchange could *qualify* under a provision (§ 112(d)) the stated *consequences* of which expressly assume the existence of a reorganization.

our interpretation of § 112(c)(1) as requiring an actual reorganization.[15]

V

THE UNDERLYING POLICY OF THE NONRECOGNITION PROVISIONS IS TO POSTPONE RECOGNITION OF GAIN ONLY IN EXCHANGES OF "LIKE-FOR-LIKE" AND STOCK IN ONE CORPORATION IS DEEMED "LIKE" STOCK IN ANOTHER ONLY WHEN THERE EXISTS BETWEEN THE TWO CORPORATIONS THAT CONTINUITY OF INTEREST THAT IS PRESCRIBED BY THE REORGANIZATION DEFINITIONS. THUS THE "LIKE-FOR-LIKE" POLICY PRECLUDES NONRECOGNITION WHERE THERE IS NO REORGANIZATION AND CONFIRMS THAT INTERPRETATION OF SECTION 112(C)(1)

In the preceding portions of this brief, we have shown that § 112(c)(1) is literally applicable only if some of the property received consists of "stock or securities in * * * a party to a reorganization" within the meaning of § 112(b)(3)—i.e., only if there is a "reorganization." In this Point we propose to show, in terms of the underlying policies, why it is that

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[15] Petitioner's attempt (Br. 17–19) to use § 112(d) in support of the opposite conclusion is untenable. The key to it seems to lie in the wholly false assumption that there could not be a true "reorganization" in which something besides "stock or securities * * * in a party to a reorganization" was received in exchange for the assets. A transaction in which "other property" was given could readily qualify as an "A" (statutory merger or consolidation) or a "D" (transfer to a controlled corporation) reorganization, and, for that matter, it cannot yet be said with certainty that there are no circumstances in which a transaction might qualify even as a "C" reorganization notwithstanding the receipt of *some* "other property". It may be noted, moreover, that § 112(d) retains the form it had before the reorganization definitions were so narrowly circumscribed, and any narrowing of the kinds of transactions to which it applies is the result of Congress' purposeful narrowing, for that very purpose, of the reorganization definitions themselves.

§ 112(c)(1) does preserve the "reorganization" requirement of § 112(b)(3).

There is in this case no disagreement about the underlying policy of the nonrecognition provisions. As stated by petitioner throughout his brief [16]—with which statements we are in full agreement [17]—the gist

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[16] "When the taxpayer has merely exchanged one thing for another of the same kind, in all practical effect he has just what he had before, merely in different form. The basic policy of the income tax structure, then, is to postpone taxation of the property received in kind until it should become the subject of some later taxable transaction, and to limit any immediate tax to the amount of any money or property other than in kind which the taxpayer receives in the exchange. This is the policy which runs throughout §§ 112 (a), (b), (c), (d) and (e)." (Br. 13.)

"* * * the legislative intent in the reorganization provisions is to permit * * * postponement of tax * * * when there is * * * 'mere change in the form of ownership.'" (Br. 14.)

"Congress was concerned [in the 1934 amendments adding the solely-for-voting-stock requirements to the "B" and "C" reorganization definitions] * * * with the tax-free receipt of stocks and securities by stockholders who had substantially changed their interest * * *." (Br. 22.)

"Congress intended as a broad policy to postpone tax effects as to *like-for-like* exchanges in a wide variety of transactions, considering it appropriate to delay the incidence of taxation until some profit or loss should actually be realized. At the same time, Congress provided for immediate taxation of 'boot' additions to like-for-like exchanges." (Br. 29.)

"Its [§ 112(c)(1)] essence is that in a like-for-like-plus-boot exchange, the tax effect as to the like-for-like is postponed while the tax effect as to the boot is immediate. * * *" (Br. 35.)

[17] Compare, for example, Treas. Regs. 118, § 39.112(a)-1(b): "* * * The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the

of the policy is that an exchange of "like-for-like" or an exchange that leaves the taxpayer's interest "substantially unchanged" and reflects only a "mere change in the form of ownership" should not be a taxable event (except of course to the extent of any "boot" received), and recognition of the "paper profit" should be postponed until it is finally realized by conversion into a different kind of property.

In applying that policy, however, there must be a standard for determining when one interest is to be deemed "like" another. That standard is to be found, and can only be found, in the nonrecognition provisions themselves. Thus, business property is deemed to be "like" business property "of a like kind" (§ 112(b)(1)); common stock or preferred stock is deemed to be "like", respectively, common stock or preferred stock in the "same" corporation (§ 112 (b)(2)); transfer of property to a controlled corporation in exchange for stock in that corporation is deemed to be but a "mere change in the form of ownership" (§ 112(b)(5)); and a stockholder's interest is deemed to be "substantially unchanged" when it survives in the corporation emerging from insolvency proceedings (§ 112(l)). In precisely the same way, whether stock in one corporation is to be deemed "like" stock in another is governed by the definition of "likeness" in § 112(b)(3)—*to wit,* stocks in two different corporations are deemed to be "likes" only if the corporations are related to each other by being "parties to a reorganization."

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new property are substantially continuations of the old still unliquidated."

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The reason that the existence of a reorganization is made the test of "likeness" is, in turn, evident, for that is precisely what the reorganization definitions are there for: the very function of the reorganization definitions is to define the "continuity of interest" between two corporations which makes an exchange of their stock a "mere change in the form of ownership" with the nature of the stockholders' interests "remaining substantially unchanged." In terms of the reorganization definition relevant here (§ 112 (g)(1)(B)), Congress has said that the requisite "continuity of interest" between the corporate entities exists only when there is at least an 80% continuity in the equity ownership between the two corporations—i.e., only when at least 80% of the stockholders in the acquired corporation receive voting stock in the acquiring corporation, thereby continuing as equity owners (though through a new parent) in the same enterprise. If there is less than that required continuity of equity ownership, the transaction, so far as Congress is concerned, is deemed merely a sale and the corporations involved are deemed to have no more relationship to each other than any other two corporations.

In this case, less than 30% of the former equity ownership of Supply survived as an equity interest in Foremost, while over 70% was "bought out" for cash. In the congressional judgment, the withdrawal of so large a part of the equity interest from the enterprise destroyed any "continuity" between the two corporations and removed the very justification for treating the stock of the two corporations as like-kind

property. By the only standard of "likeness" that can be found in the Internal Revenue Code, therefore (and the standard expressly stated in § 112(b)(3)), the Supply stock and Foremost stock involved in this case were not, as petitioner asserts, "likes" but were, to the contrary, as "unlike" as the stock of any two corporations having no relationship to each other.

The reason, then, that § 112(c)(1) requires a reorganization is precisely because its "essence" *is*, as petitioner puts it (Br. 35):

> * * * that in a like-for-like-plus-boot exchange, the tax effect as to the like-for-like is postponed while the tax effect as to the boot is immediate. * * *

For whether the two corporations are parties "to a reorganization" is the very test of whether the stocks exchanged are deemed to be "like" each other. If there is no reorganization—i.e., if there is not the requisite "continuity of interest" between the two corporations to justify treating the exchange of securities as a "mere change in the form of ownership"—there simply does not exist a "like-for-like" element in the exchange. There is only an exchange of what are deemed to be "unlike" properties (stock in two unrelated corporations), which even petitioner concedes is fully taxable.

2. Viewed in terms of the underlying policies of the nonrecognition provisions, the speciousness of petitioner's claim that a hypothetical reorganization suffices to satisfy the "boot" provision becomes evident. It is true enough that, if petitioner had received no cash and only voting stock in Fore-

most, there would have been the continuity of equity ownership between the two corporations requisite to constitute a "reorganization" and to justify treating the stocks of each as substantial equivalents. In policy terms, however, "what might have been" has nothing to do with whether the stock petitioner actually received should be treated as "like" the stock he gave up—i.e., stock in two corporations between which there in fact exists no continuity of interest. What happened is decisive. So far as Congress has defined "likeness", petitioner in fact received property (the Foremost stock as well as the cash) entirely "unlike" the property he gave up. and the only applicable policy is that which requires full recognition of gain in an exchange of "unlikes" (§ 112(a)). Petitioner's hypothetical reorganization proves only that the exchange consisted of "like-for-unlike [but which would have been 'like' if the facts had been different]-plus-cash", and petitioner has yet to prove a policy of making tax-free an exchange of "unlikes hypothetically alike."

VI

PETITIONER'S INTERPRETATION OF THE NONRECOGNITION PROVISIONS IS INCONSISTENT WITH THE PROVISIONS GOVERNING THE ACQUIRING CORPORATION'S BASIS AND DEPRIVES THE SOLELY-FOR-VOTING-STOCK LIMITATION OF THE REORGANIZATION DEFINITION OF ANY MEANINGFUL FUNCTION

The argument in this brief has thus far been confined to the nonrecognition provisions themselves. In this Point we shall widen the discussion to show that petitioner's interpretation of those provisions cannot be reconciled with the related provisions of

the Code governing the "basis" of property acquired in stock-for-stock exchanges.

1. If a stockholder exchanges his stock in one corporation for stock in another (the "acquiring corporation"), it is true, as petitioner contends, that the *stockholder's* basis for his new stock will, under § 113(a)(6), be fixed consistently with his recognition or nonrecognition of gain on the exchange (to the extent that his gain is not recognized, his basis for the new stock will be the same as his basis for the old stock). What petitioner ignores, however, is the relationship between the stockholder's recognition of gain or loss and the basis to the *acquiring corporation* for the property acquired by it, and it is between those two consequences that the inconsistent results of petitioner's interpretation appear.

The basic rules governing the effect of such an exchange upon the acquiring corporation are these: If a corporation issues its own stock in exchange for stock of another corporation—or, for that matter, for money or any other kind of property—it realizes no gain upon that transaction whether or not there is a reorganization, since the transaction amounts simply to a stock subscription (Treas. Regs. 118, § 39.22(a)-15 (b)). Whether there is a reorganization is, however, important in determining its basis for tax purposes upon sale of the stock of the other corporation which it acquired. If no exception applies, its basis, under the general rule (§ 113(a)), is "cost," which is determined by the fair market value of the consideration (i.e., its own stock) given in exchange. If, however, a corporation acquires property "in connection with

a reorganization," then under § 113(a)(7) it is required to take the property with the same basis it had in the hands of the transferor (with appropriate adjustments for the gain or loss recognized by the transferor). Thus whether the acquiring corporation receives a "carryover" basis (equal to the transferor's basis) or a "stepped-up" basis (equal to fair market value[18]) depends entirely upon whether the transaction qualifies as a reorganization.

Since recognition or nonrecognition of gain by the transferor under §§ 112(b)(3) and (c)(1) also depends upon there being a reorganization—except of course for petitioner's claimed exception—it is evident that there is a close relationship between the nonrecognition of gain by the transferor and the carryover of basis to the acquiring corporation. That relationship, and the incongruous departure from it that would result from petitioner's interpretation of § 112(c)(1), can be shown by three examples, the first two of which are not, we believe, subject to dispute. In each case, it is assumed that *A* owns 81 of the 100 shares outstanding of the Old Corporation; that none of the other stockholders participate in the transaction; that *A*'s cost basis for the Old stock is $10 a share; and that the value of the stock of the New Corporation (all voting stock) is $100 a share:

Example 1: A exchanges 79 shares of Old stock for 79 shares of New stock. Since New Corporation acquired less than 80% of the Old stock, there is no re-

[18] Theoretically, this is the value of the stock given in exchange, rather than the value of the stock received, but the two will normally be the same.

organization. *A*'s gain of $90 a share (value of New stock, $100, less basis for Old stock, $10) is fully recognized (§ 112(a)).[19] New Corporation's basis for the Old stock is $100 a share ("cost," § 113(a), which is equal to the value of the New stock given in exchange). In brief:

(a) There is no reorganization.

(b) *A*'s gain is fully recognized.

(c) New Corporation receives a "stepped-up" basis.

Example 2: A exchanges all 81 shares of Old stock for 81 shares of New stock. Since New Corporation acquired more than 80% of the Old stock in exchange solely for its voting stock, there is a "B" reorganization. *A*'s exchange therefore qualifies under § 112(b)(3) and no gain is recognized. However, since New Corporation acquired the Old stock in a reorganization, it must, under § 113(a)(7), take over *A*'s $10-a-share basis for the stock, rather than a $100 "cost" basis. In brief:

(a) There is a reorganization.

(b) *A*'s gain is not recognized.

(c) New Corporation takes a "carryover" basis.

Example 3: A exchanges 81 shares of Old stock for 79 shares of New stock plus $200 in cash. Although New Corporation acquired more than 80% of the Old stock, there is no "B" reorganization because it did not do so in exchange "solely" for voting stock. In our view, the consequences would be precisely the

[19] Petitioner's "boot" argument would not apply, since the reason the transaction fails to qualify as a "B" reorganization is the failure to acquire 80% of the stock, not the presence of something other than voting stock.

same as in Example 1 (full recognition of gain; stepped-up basis) in which, though for a different reason, there was similarly no reorganization. Under petitioner's interpretation of § 112(c)(1), however, the gain would be recognized only to the extent of the cash—$200 in all, or about $2.50 per share for the 81 shares—notwithstanding the absence of an actual reorganization. Since the "carryover" basis provision (§ 113(a)(7)) applies only to actual, and not hypothetical, reorganizations, however, the New Corporation would still get a "stepped-up" basis ($100 per share) notwithstanding the almost total nonrecognition of gain by *A*. In brief, under petitioner's view:

(a) There is no reorganization.

(b) Only $2.50 of petitioner's $90 per-share gain is recognized.

(c) New Corporation receives a "stepped-up" basis.[20]

Those examples make clear, we think, the anomalous results of petitioner's argument. In every other context, qualification as a "reorganization" permits nonrecognition of gain but only at the price of the acquiring corporation's taking over the transferor's

[20] That is, stepped-up to the full $100 "cost" of the stock, and not simply by the amount of *A*'s recognized gain—i.e., from $10, *A*'s basis, to $12.50. It may be noted that if the exchange were in fact (instead of only "hypothetically") a reorganization, *A*'s recognized gain would be limited to the same amount as is claimed under petitioner's argument ($2.50), but with the additional consequence that New Corporation would have to take *A*'s basis in the Old stock ($10 a share) increased only by the amount of gain recognized by *A* ($2.50 a share) (§ 113(a)(7)).

low basis (Example 2), while failure to qualify as a "reorganization" permits the acquiring corporation to take a "stepped-up" basis but only at the price of the gain being fully recognized by the transferor (Example 1). In petitioner's view, however, the best of both worlds (nonrecognition of gain *and* a "stepped-up" basis) can be had if the acquiring corporation acquires enough stock to meet the 80% requirement of § 112(g)(1)(B) but takes care to pay cash for some of it in order to avoid meeting the solely-for-voting-stock requirement (Example 3). In such a case, there is no actual reorganization, so the acquiring corporation gets a stepped-up "cost" basis, but there is a hypothetical ("but for the cash") reorganization, so that, under petitioner's interpretation of § 112(c)(1), the gain is recognized to the transferor only to the extent of the cash. Such a transaction, in short, is to be treated "as though it were" a reorganization for purposes of the desirable consequences of reorganizations (nonrecognition of gain) but as in fact *not* a reorganization for purposes of the undesirable consequences (carryover of the low basis to the acquiring corporation).

The anomaly of the basis consequences of petitioner's argument is perhaps even more apparent in an assets-for-stock acquisition. Assume that the *X* Corporation, with fully-depreciated business assets, transfers all its assets to the *Y* Corporation in exchange mostly for voting stock but also enough for cash to prevent qualification as a "C" reorganization. There being no reorganization in fact, as required by § 113(a)(7), *Y* Corporation obtains a new "cost"

basis (measured by the cash plus the value of the *Y* stock it gave in exchange) for the assets, on which it is entitled to take depreciation. Under petitioner's view, however (which he acknowledges (Br. 18) is equally applicable to such a case), the *X* Corporation's gain would, under § 112(d), be recognized only to the extent of the nominal amount of cash received. Thus, by recognizing but a small fraction of the gain, the *X* Corporation would obtain the benefit (through its stock holdings in the *Y* Corporation) of a brand-new, full market value, basis for depreciation of its previously fully-depreciated assets.

That that result, divorcing the basis consequences from the recognition-of-gain consequences, defeats the policy of statute is evident, for precisely the same policy underlies the carryover-of-basis provision and the nonrecognition provisions. Nonrecognition of gain is allowed, as we have seen, on the theory that the receipt by the corporation that formerly owned the assets, of stock in the corporation that now owns them, results in a "mere change in the form of ownership" with the beneficial interests in the underlying enterprise continuing on "substantially unchanged." But it is for exactly the same reason that the acquiring corporation is required to take over the transferor's basis in the assets—with the same persons retaining a continuing interest "substantially unchanged" in the same enterprise, there is no justification for a change in the enterprise's depreciation basis. In short, if the transaction is not to be treated as a "sale" by the transferors, with a reckoning up of gain, it can hardly be treated as a "purchase" by the

transferee, with a new "cost" basis being created. Neeessarily, we submit, if the basis-carryover provision (§ 113(a)(7)) requires an actual reorganization—as it clearly does and as petitioner does not attempt to deny—the nonrecognition provisions cannot be interpreted to permit nonrecognition of gain without an actual reorganization. They are companion pieces in a complex fabric governing the several tax consequences of corporate reorganizations and acquisitions and must be interpreted consistently with each other.

2. A related point is that, since the basis and nonrecognition consequences discussed above are the *only* consequences of qualifying or not qualifying as a "B" reorganization,[21] petitioner's interpretation of the "boot" provision has the effect of depriving the solely-for-voting-stock limitation in § 112(g)(1)(B) of any rational purpose at all. If Congress had omitted

[21] In some types of transactions, such as assets acquisitions (e.g., "C" reorganizations), qualification as a reorganization may also be important in determining whether the acquiring corporation "inherits" from the transferor corporation certain "tax attributes" (earnings and profits, loss carryovers, etc.)—matters explicitly governed by § 381 of the 1954 Code (see Pet. Br. 2, 29) but left largely to judicial formulation under the 1939 Code. In a stock acquisition of the "B" type, however, the corporation as such survives (becoming a subsidiary of the acquiring corporation) and there is no question of transference of its tax attributes to another corporate entity. In such a transaction, therefore, the only consequences turning on the reorganization definition are (a) nonrecognition of gain to the transferor-stockholders under § 112(b)(3) and (c)(1); and (b) carryover of basis under § 113(a)(7) to the acquiring corporation. The limitations on the "B" definition have meaning, therefore, only insofar as they affect those two consequences of an exchange.

that requirement entirely from the definition of a "B" reorganization—and had instead simply limited nonrecognition under § 112(b)(3) to "voting stock" in the case of "B" reorganizations, with everything else being treated as "boot"—the result would have been precisely the same as that contended for by petitioner, with this single difference: the inconsistent basis consequence discussed above would have been avoided.[22] That is, if petitioner's interpretation of § 112(c)(1) is correct, then the only consequence of adding the solely-for-voting-stock limitation to the "B" definition was to create a tax loophole by giving a *preferred* status to transactions which *failed* to meet it (nonrecognition of gain without the resulting carry-over of basis required in all other "reorganization" exchanges). Not even petitioner, we believe, will argue that that was the intended purpose of the limitation (rather than, at best, an unintended by-product), and there is thus left no explanation at all for the addition of that limitation.

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[22] Since there would then be a "reorganization," § 113(a)(7) would require the acquiring corporation (here, Foremost) to take the transferor's (petitioner's) basis increased only by the gain actually recognized by the transferor—not, as is true under petitioner's contention, a stepped-up basis equal to the full market value of the stock.

VII

THE LEGISLATIVE HISTORY OF THE "BUT FOR" TEST OF THE "BOOT" PROVISION SHOWS THAT THE ADOPTION OF THAT LANGUAGE IN THE REVENUE ACT OF 1924 WAS NOT INTENDED TO EFFECT A SUBSTANTIVE CHANGE FROM THE DIFFERENTLY WORDED PROVISIONS OF THE REVENUE ACT OF 1921, UNDER WHICH IT WAS CLEAR THAT A REORGANIZATION WAS ESSENTIAL TO NONRECOGNITION OF GAIN

As petitioner repeatedly proclaims, his argument is based, not upon a claim that the transaction was actually a reorganization under § 112(g), but upon an interpretation of the "boot" provision, § 112(c)(1), as permitting nonrecognition in non-reorganization exchanges which "would have" qualified as reorganization exchanges "but for" the money received. Specifically, as we understand the argument, petitioner relies exclusively upon the hypothetical "but for" language of § 112(c)(1). The controlling legislative history, then, is not that of the reorganization definitions, but that of the "but for" language of § 112(c)(1). That history, we will show, reveals that the "but for" language was not in fact intended, and could not have been intended, to have the effect petitioner attributes to it.

1. The "boot" provision first appeared as § 202(c) of the Revenue Act of 1921, 42 Stat. 227. Petitioner refers to that provision as the "counterpart" of

§ 112(c)(1), and with that description we wholeheartedly agree. For the "boot" provision of the 1921 Act, although otherwise similar in function and purpose to § 112(c)(1), did *not* employ the "but for" language upon which petitioner's entire case depends. The history of the Revenue Act of 1924, in which the "but for" language was first adopted, shows, in turn, that that change in phraseology was not intended to effect a substantive change.

Section 202(c)(2) of the Revenue Act of 1921 was the forerunner of both § 112(b)(3) and § 112(g)(1) of the 1939 Code, the reorganization definitions at that time having been included in the nonrecognition provision itself. Section 202(e) was the "boot" provision from which § 112(c)(1) was ultimately derived. In relevant part those sections of the 1921 Act, as amended in a minor respect in 1923, provided:

> [§ 202(c)] * * * no gain or loss shall be recognized—* * * (2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation [*etc.*] * * *.
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> * * * * * *
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> [§ 202(e)] * * * when property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property * * * other than that specified in such

> paragraphs, the [23] amount of the gain resulting from such exchange shall be computed in accordance with subdivisions (a) and (b) of this section, but in no case shall the taxable gain exceed the amount of the money and the fair market value of such other property received in exchange.

Since the crucial "but for" language is missing from those provisions, the elaborate argument petitioner has structured upon that language is inapplicable to them,[24] and they can be read in the straightforward

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[23] The remaining part of the sentence is set forth as amended by the Act of March 4, 1923, 42 Stat. 1560. Before that amendment it read:

"* * *, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess."

That is the only change in the quoted provisions made by the 1923 amendment. The only effect of that amendment, it may be seen, was to change the method of accounting for the "boot": under the original 1921 Act, the "boot" was applied first in reduction of basis to the extent of the basis and only the excess treated as gain; under the 1923 amendment, the "boot" is treated first as gain to the extent of the gain, and only if the "boot" exceeds the gain is the excess applied in reduction of basis.

That change is irrelevant here, since we are concerned only with the test of qualification under the "boot" provision, and not with the method of accounting for the "boot" once it is determined to be applicable. Petitioner's reliance on the committee report on the 1923 amendment (Br. 20)—which simply explained the difference in the method of computation and was directed not at all to the kinds of exchanges to which the provision applied—is therefore entirely misplaced.

[24] That makes petitioner's reliance (Br. 20) on the history of the 1923 "accounting" amendment not only misplaced (see note 23, *supra*) but specious. The statute did not at the time

manner in which they are written. Section 202(c) provides that no gain or loss shall be recognized on the receipt, incident to a reorganization, of "stock or securities in a corporation a party to * * * [a] reorganization." Section 202(e) provides, in equally direct terms, that the gain will be recognized to the extent that any "other property" is received, with "other property" being doubly identified as property "other than that specified in" § 202(c)(2)—i.e., anything that is not "stock or securities in a corporation a party to * * * [a] reorganization." In short, under the 1921 Act, it was beyond dispute that there could be no nonrecognition of gain without a reorganization.

Petitioner's argument, therefore, requires him to show that a substantive change was effected by the Revenue Act of 1924, 43 Stat. 253, 257, in which both the nonrecognition provision (now, § 112(b)(3)) and the "boot" provision (now, § 112(c)(1) were given the form they have retained ever since. That Act, however, provides a different explanation for the change of language and the committee reports confirm that no substantive change was intended.

The 1924 Act effected a major cleaning-up and modernization of the rather haphazardly placed reorganization and nonrecognition provisions of the 1921 Act. For example, the nonrecognition provisions were separated from the basis provisions with which they had been joined; the reorganization definitions were placed in a subsection separate from the nonrecognition provisions; and the several nonrecognition

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of that amendment even include the language on which petitioner relies.

provisions were all rephrased in a unified style. Of particular relevance here is that in the rephrasing of all of the nonrecognition provisions (not simply what is now § 112(b)(3) but the provisions governing other kinds of exchanges as well) there was added the requirement, not present in the wording of the 1921 Act, that the property received consist "solely" of the specified kind. It is the addition of that requirement, we submit, that provides the complete explanation for the "but for" rephrasing of the "boot" provision.

Since the basic nonrecognition provisions of the 1921 Act (see, e.g., § 202(c)(2) quoted above, which was typical) were not limited to exchanges in which "solely" the described kind of property was received, they remained applicable notwithstanding the receipt of other property in addition to the specified kind, and it was therefore sufficient for the "boot" provision simply to prescribe directly the treatment to be given the "other property"—i.e., that the gain should be recognized to its extent. With the addition of the "solely" requirement, however, the receipt of any "other property" would be a total bar to qualification under the basic provisions. Hence it was no longer enough for the "boot" provision to say simply that the "other property" was taxable; it had also to give back what the "solely" requirement had taken away—i.e., by affirmatively according nonrecognition to the property that "would have" qualified under the basic provisions "but for" the "solely" requirement. In short, the addition of the "solely" requirement in the

predecessors of §§ 112(b) (1), (2), (3), and (5) [25] by itself made it essential that the "boot" provision, if it was to continue to perform the *same* function it had in the 1921 Act, be recast into its present form.

The committee reports accompanying the 1924 Act confirm that that was the sole reason for the change in the wording of the "boot" provision and that no substantive change in its effect was intended. Their only comments about the rewording of either what is now § 112(b)(3) (§ 203(b)(2) of the 1924 Act) or what is now § 112(c)(1) (§ 203(d)(1) of the 1924 Act) were as follows:

> [Section 203(b)(2)], together with section 203(h)1 [the section into which the reorganization definitions were put, now § 112(g)(1)], with the exception of minor changes in phraseology, is the same as section 202(c)2 of the existing law [the 1921 Act].
>
> * * * * * *
>
> [Section 203(d)(1)] * * * corresponds to section 202(e) of the existing law * * *, and provides that where "boot" is given in connection with an exchange which would otherwise be tax free, the gain from the exchange shall be recognized, but in an amount not in excess of the amount of the money or other "boot." [26]

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[25] The "solely" requirement was also added to § 112(b)(4), but that is governed by a separate "boot" provision. See Point IV, *supra*.

[26] H. Rep. 179, 68th Cong., 1st Sess., pp. 1, 13, 14 (1939–1 Cum Bull. (pt. 2) 241, 251, 252); S. Rep. 398, 68th Cong., 1st Sess., pp. 1, 13, 14 (1939–1 Cum. Bull. (pt. 2) 266, 276, 277).

The change of wording in the 1924 Act is the only change that occurred in the nonrecognition and "boot" provisions between §§ 202(c)(2) and (e) of the 1921 Act and §§ 112(b)(3) and (c)(1) of the 1939 Code, and there has been no further congressional comment on those provisions. If, then, a reorganization was essential to nonrecognition under the 1921 Act (as it indisputably was), and no substantive change was intended by the rewording of the 1924 Act (as clearly none was), the foundation for the castle petitioner has built upon the "but for" language adopted in 1924 is destroyed. The "boot" provision today means precisely the same thing it did in 1921: if some of the property received is the kind described in the basic provision (not hypothetically but in fact) and some is not, the former is tax-free and the latter is not.

2. We may add that not only was the "but for" language of the 1924 Act not in fact intended to extend nonrecognition to hypothetical reorganizations, but it could not have been so intended. The reason is that, as reorganizations were defined in that Act, there was at that time no way to make such a use of the "but for" language. Section 203(h)(1) of the 1924 Act defined a reorganization as follows:

> The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all of the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if

> immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

It may be seen that none of those definitions prescribed, in terms, any limitation on the kind of consideration that might be received. A failure to qualify as a "reorganization" could not, therefore, be specifically attributed to the receipt of some particular kind of property, and hence there was no way to say that "but for" a particular receipt there "would have been" a reorganization.[27] Thus, petitioner's argument attributes to the "but for" language adopted in 1924 a purpose that it could not possibly have had at the time it was adopted.

It was not, it should be noted, until the Revenue Act of 1934, 48 Stat. 680, ten years after the "but for" language was adopted, that the specific solely-for-voting-stock limitation was added to what are now

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[27] It is true that the "continuity of interest" test judicially developed to confine those definitions to transactions fitting their spirit as well as their letter had the practical effect of limiting the kinds of property that might be received in exchange, say, for "substantially all" a corporation's assets. See, e.g., *LeTulle* v. *Scofield*, 308 U.S. 415, 418; *Pinellas Ice & Storage Co.* v. *Commissioner*, 287 U.S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378; *Cortland Specialty Co.* v. *Commissioner*, 60 F. 2d 937 (C.A. 2). Surely, however, petitioner will not claim that his purportedly "literal" but-for theory is so flexible that it permits a recipient to assume away simply whatever undefined part of the receipts would be sufficient to restructure the transaction in such a way that the imprecise "continuity of interest" standard would be met.

the "B" and "C" reorganization definitions, and it is only with that specific limitation that petitioner's argument, even in his own terms, becomes applicable. And to say that Congress in adopting the "but for" language in 1924 intended to create a "potential" method of qualifying hypothetical reorganizations for nonrecognition which it "completed" ten years later is to suggest, to say the least, a unique form of two-step legislation. Rather, the only purpose the "but for" language could have had in 1924 was to alleviate the "solely" requirement concurrently added to the nonrecognition provisions. Its purpose in 1924 could not have been to alleviate the "reorganization" requirement, and, with no intervening change in the statute, that purpose cannot be attributed to it now.[28]

3. In the light of what seems to us the conclusiveness of the history of the "boot" provision itself—the provision upon which petitioner's argument directly

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[28] The same analysis is true of the provision originating as § 203(f) of the 1924 Act (now § 112(e)). That provision is a companion to § 112(c)(1) and the test of qualification is the same. The only difference is that turning on whether the exchange results in a gain or a loss: § 112(c)(1) makes the gain recognizable to the extent of the "boot", while § 112(e) provides that the presence of "boot" will not affect the nonrecognition of loss.

The quotation from the committee report on § 203(f) of the 1924 Act on which petitioner relies (Br. 21) is, on its face, addressed solely to the question of the effect on loss-recognition of a failure to meet the "solely" requirement of the nonrecognition provisions themselves—i.e., a case in which some of the property received is of the kind described in those provisions and some is not. It is not, and could not be, addressed to a failure to quality as a reorganization because property other than voting stock was received, since, as pointed out in the text, the solely-for-voting-stock requirement was not yet in existence.

rests—we need not examine in detail the history of the revised "reorganization" definitions adopted in the Revenue Act of 1934, in which the solely-for-voting-stock requirement first appeared. To the extent that it is relevant, that history is sufficiently set forth in the opinion of the court of appeals (R. 58–61). And in answer to petitioner's misuse of that history, it is sufficient to point out that everything said in connection with the 1934 Act about the desirability of allowing nonrecognition of gain, preventing the recognition of losses, or providing equality of treatment in states in which statutory mergers or consolidations were unavailable, was addressed to a single question—what transactions should be defined as reorganizations. Every consequence or objective mentioned was thought to be a consequence of qualifying or not qualifying *as a reorganization,* and there is nothing in that history to suggest that anything turns upon "what might have been" a reorganization. Thus, even petitioner's assertion that Congress was primarily concerned in the 1934 Act with preventing recognition of "paper losses" proves the opposite of his point. For the 1934 Act dealt *only* with the reorganization definitions, and it must be, therefore, that Congress thought its objects, whatever they were, could be achieved simply by varying the reorganization definitions as such. And that is true only if, as we contend and *contrary* to petitioner's contention, qualification or nonqualification as a reorganization is the touchstone upon which recognition or nonrecognition of loss directly depends. Petitioner, in short, can hardly rely on what Congress sought to achieve

by defining reorganizations in support of an argument that there can be nonrecognition of gain without a reorganization.

In fact, of course, what Congress sought to achieve by adding the solely-for-voting-stock requirement for a "B" or "C" reorganization was a stricter continuity-of-interest test (see *Helvering* v. *Southwest Corp.*, 315 U.S. 194, 198). The very purpose of the continuity-of-interest test is, in turn, to say when there is such a successorship between two corporations as to justify treating exchanged interests in them as a "mere change in the form of ownership" not justifying the imposition of a tax—i.e., to say when gain should or should not be recognized. And that is precisely the consequence of the solely-for-voting-stock limitation that petitioner's argument would deny.

VIII

THE REGULATIONS PERMIT NONRECOGNITION IN STOCK-FOR-STOCK EXCHANGES ONLY IF THERE IS A REORGANIZATION

1. The regulations under the "boot" provision (Treas. Regs. 118, § 39.112(c)–1(c), hereafter cited only by section number) refer, for the treatment of "boot" in reorganization exchanges, to the following provision:

> SEC. 39.112(g)–4. *Exchanges in reorganization for stock or securities and other property or money.* (a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the

> taxpayer other property (not permitted to be received without the recognition of gain) or money, then
>
> (1) As provided in section 112(c)(1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property * * *.

That regulation, it may be seen, is a restatement of § 112(b)(3) and § 112(c)(1) read together. It puts them together in such a way, however, as to eliminate the "but for" reference and make clear that the "boot" provision applies to such exchanges only when some "stock or securities in a corporation a party to a reorganization" are in fact received but some "other property" is also received. If valid, therefore, that regulation controls this case, where no "stock or securities in a corporation a party to a reorganization" were in fact received.[29]

2. Equally explicit is § 39.112(g)-1(c) which provides in part:

> The nonrecognition of gain or loss is prescribed for two specifically described types of [reorganization] exchanges, viz: The exchange that is provided for in section 112(b)(3) * * * [and] in section 112(b)(4) * * *. Certain rules respecting boot received in either of the two types of exchanges * * * are prescribed in sections 112(c) and 112(d). * * * The provisions of the Internal Revenue Code referred to in this paragraph are inapplicable unless there is a plan of reorganization. * * *

[29] What the Tax Court found in that regulation to support the opposite result (R. 40-41) is not clear.

That again interprets § 112(c)(1), the "boot" provision, as being limited, as it applies to § 112(b)(3)-type exchanges (i.e., stock-for-stock), to exchanges incident to actual, not hypothetical, reorganizations.[20]

3. In addition to those explicit provisions, there runs throughout the regulations the underlying assumption that, in the area of stock-for-stock exchanges, "reorganization" and "nonrecognition of gain" are but different aspects of the same thing. Thus, for example, the statement that the "underlying assumption of these exceptions [to recognition of gain] is * * *, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated" (§ 39.112(a)-1(b)) seems implicitly to equate nonrecognition with the existence of a reorganization. The same is true of the statement that "The purpose of the reorganization provisions * * * is to except from the general rule [of recognition of gain] certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code [i.e., by the reorganization definitions], as are required by business exigencies, and

[20] Petitioner objects to that regulation on the ground that § 112(c)(1) also applies to other types of exchanges which do not involve reorganizations, e.g., § 112(b)(1)-type exchanges (Br. 33). Of course it does, but it is equally plain that the regulation is speaking only of the interaction of § 112(c)(1) with § 112(b)(3), not with the various other nonrecognition provisions. It is only that interaction that is involved here, and as to that the meaning of the regulation is plain.

which effect only a readjustment of continuing interests in property under modified corporate forms" (§ 39.112,(g)–1(b)). The same implication is present also, for a final example, in the statement, following a description of the "specifications of the reorganization provisions," that "Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule," the "general rule" being that requiring gain to be recognized (*ibid.*).

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
WAYNE G. BARNETT,
Assistant to the Solicitor General.
HARRY BAUM,
ARTHUR I. GOULD,
Attorneys.

OCTOBER 1961.

APPENDIX

INTERNAL REVENUE CODE OF 1939
(26 U.S.C., 1952 ed.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for stock of same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. * * *

* * * * *

(10)[1] *Gain or loss not recognized on reorganization of corporations in certain receivership and bankruptcy proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership, foreclosure, or similar proceeding, or

(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization ap-

[1] This provision and § 112(l), *infra*, and all references to them in the other provisions, were added by the Revenue Act of 1943, § 121, 58 Stat. 21.

proved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

* * * * *

(c) *Gain from Exchanges Not Solely in Kind.*—

(1) If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—Gain of Corporation.*—If an exchange would be within the provisions of subsection (b)(4) or (10) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the

corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from Exchanges Not Solely in Kind.*—If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, or (10), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

* * * * *

(g) *Definition of Reorganization.*—As used in this section (other than subsection (b)(10) and subsection (l)) and in section 113 (other than subsection (a)(22))—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall

be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

* * * * *

(l) *Exchanges by Security Holders in Connection with Certain Corporate Reorganizations.*—

(1) *General rule.*—No gain or loss shall be recognized upon an exchange consisting of the relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (b)(10), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS—(a) *Basis (unadjusted) of Property.*

The basis of property shall be the cost of such property; except that—

* * * * *

(6) *Tax-free exchanges generally.*

If the property was acquired, after February 28, 1913, upon an exchange described in section 112(b) to (e), inclusive, or section 112(l), the basis * * * shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount

of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) or section 112(l) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received * * *.

(7) *Transfers to corporation.*

If the property was acquired—

* * * * *

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

* * * * *

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REPLY BRIEF FOR PETITIONER

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In the Supreme Court of the United States

October Term, 1961

No. 60

George B. Trumbo and Boyd H. Trumbo,
Petitioners,

v.

Commissioner of Internal Revenue,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONERS

Thomas N. Kimball,
Harry P. Warren,
Francis H. Morrison,
Wadsworth J. McPherson,
Standard Oil Building,
San Francisco 20, California,
Attorneys for Petitioners.

Pillsbury, Madison & Sutro,
Standard Oil Building,
San Francisco 20, California,
Of Counsel.

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Commissioner of Internal Revenue,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONERS

The Commissioner's brief is no answer to the case; it omits all consideration of the legislative purpose and the effect of the "boot" provisions in their relation to the nonrecognition (i.e., tax deferment) provisions of the Internal Revenue Code, and it studiously avoids all consideration of the effect of its argument on the correlative "loss" provision (§ 112(e)) of the Code. When these matters are considered, the unsoundness of the Commissioner's reasoning stands out in sharp focus.

FIRST: THE COMMISSIONER'S INTERPRETATION OF § 112(c)(1), ADMITTING AS HE DOES THAT THE TEST UNDER THAT SECTION AND UNDER § 112(e) IS THE SAME, WOULD OPEN UP A LARGE TAX LOOPHOLE UNDER § 112(e) (NOW § 356(c) OF THE 1954 CODE).

In attempting to close the door on tax deferment as to the voting stock component of a voting-stock-for-voting-stock corporate acquisition despite current full taxation of gain to the extent of any accompanying boot, the Commissioner has opened wide another door to a method of converting paper losses into tax losses under § 112(e) of the 1939 Code (now § 356(c) of the Internal Revenue Code of 1954) (Petr.Br. 15-17, and Appx. ii and iv). The Commissioner's brief does not dispute that the similar language of §§ 112(c)(1) and (e) must be similarly read and applied (*Davies Warehouse Co. v. Bowles* (1944) 321 U.S. 144, 150; *Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943; Petr.Br. 15). In fact, his brief notes in passing that the test or qualification is the same under both §§ 112(c) and (e) (Resp.Br. 63, note 28).

The Commissioner does not discuss the effect of this new apparent loophole, nor does he discover to the Court any evidence of or reason supporting any supposed Congressional intent or purpose in that direction.

Following the Commissioner's theory: If a stockholder whose stock had largely *depreciated* in value should exchange it (as part of not less than 80% of the voting stock of the corporation) for voting stock of another corporation pursuant to a plan of reorganization, he could of course not claim a tax loss since § 112(b)(3) specifically provides that no loss shall be recognized in that situation. But if he should arrange to receive in addition a

dollar in cash, then: § 112(b)(3) would not apply because the exchange was not "solely" for stock or securities; the transaction would no longer "qualify" as a "reorganization"; therefore the "but for" hypothesis in § 112(e) could not apply and that section would not preclude recognition of loss; hence under the basic statute, § 112(a), the taxpayer could take the entire paper loss as a tax loss.

The court in the *Howard* case (*Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943)) agreed that such a result was never within the language or the intent of § 112(e). The pertinent committee reports emphasize the Congressional purpose to prevent the taking of tax losses when the taxpayer retains a continuing interest in merely changed form (quotations, Petr. Br. 15-16, 21-22, 25). If the Commissioner's interpretation should now prevail and this handy tax-loss device be opened up, the effect could be serious indeed.

Though these matters were presented in our opening brief, the Commissioner has not suggested any answer. But he does not escape the problem by looking the other way. The force of this element alone—the effect of the Commissioner's argument on the correlative loss provision—is itself, we respectfully submit, so cogent as to compel rejection of the Commissioner's reading of the statutes.

SECOND: THE COMMISSIONER'S BRIEF IGNORES THE INCONSISTENCY OF HIS INTERPRETATION WITH CONGRESS'S DEMONSTRATED (AND ADMITTED) TAX POLICIES AND PURPOSES. THE TAXPAYER'S POSITION, ON THE CONTRARY, EFFECTUATES THE CONGRESSIONAL POLICIES AND CARRIES OUT THE LEGISLATIVE PATTERN.

The fundamental Congressional policies are clear. On the one hand, Congress intended in general to tax immediately the gain resulting from sales or exchanges (§ 112(a)); on the other hand it recognized and expressed a policy not to impede or discourage business readjustments which went rather to the form of the taxpayer's property interest than to the substance (*Seiberling Rubber Co. v. Commissioner of Internal Revenue* (6 Cir. 1948) 169 F.2d 595, 597; *Commissioner of Internal Revenue v. Gilmore's Estate* (3 Cir. 1942) 130 F.2d 791, 794). By postponing taxation[1] until some more pronounced change of position should occur, desirable business flexibility could be preserved while losing none of the prospect of taxing the profit when and as ultimately realized.

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[1]One fact must always be remembered: While much has been said about "tax-free" exchanges under the nonrecognition provisions, they are not tax free, but the tax is merely deferred until some profit is actually realized. Nonrecognition does not impute any escape from taxation (Magill: Taxable Income, Revised Edition, 1945, p. 144; and authorities cited in our opening brief, page 13).

Nor does §112 (e)(1) make gains tax free, or even necessarily defer *any* taxes. If the amount of the boot equals or exceeds the amount of the gain, the entire gain is taxed immediately. It is only when part of the gain resides in the voting stock received, that Congress limits the amount of recognized gain to the amount of the boot.

Turnbow does not escape taxation; he has paid his full taxes on his gain to the extent of the cash boot, and taxation of any ultimate profit on the stock received is inchoate and will become consummate whenever he sells the stock.

The question is merely one of recognizing and applying the expressed purpose of Congress in the timing of the taxes.

The tax-deferred, like-for-like category is not unlimited, of course. It does not include an exchange of Standard Oil stock for General Motors stock, for example, though both may be industrial common stocks. Moreover, Congress has changed or narrowed the category at times. But within the category as set forth by Congress from time to time are the exchanges which Congress has determined to merit this tax-deferred flexibility.

Where for business reasons some cash or other property (in addition to the like-for-like property) must be added to the consideration, § 112(c)(1) effectuates both policies by preserving the tax deferment as to the like-for-like property while immediately taxing any gain to the extent of the cash or other boot.

The Commissioner is "in full agreement" that such are the underlying Congressional policies (Resp.Br. 42-43), but signally avoids any effort to reconcile his interpretation of § 112(c)(1) with them. This avoidance is understandable, since his position is irreconcilable with the full and eminently practical satisfaction of both policies.

The taxpayer's position effectuates both legislative policies. Deferment of taxation to the extent of the value of the stock received recognizes that Turnbow's equity interest in the Supply enterprise continues in the form of his equity interest in Foremost, of which Supply continues in business as an operating subsidiary—a typical form of corporate reorganization. At the same time, he has paid all taxes on his gain to the full extent of the added cash.

The Commissioner admits (Resp.Br. 45-46) that if Turnbow had received only Foremost voting stock and no

cash, the stock components would be like-for-like and the requisite continuity of interest would obtain. But, he argues, if *any* cash is added, the continuity of interest residing in the exchange of stock disappears entirely, and even the stock elements are no longer like-for-like and the corporations have become strangers (Resp. Br. 45). This, we respectfully submit, does not make either good tax sense (the gain to the full extent of the cash is immediately taxable) or good economic sense. Some amount of cash may have to be added to the consideration—or part of the consideration for one from among many stockholders—for any one of a score of economic reasons. The stockholder-taxpayer's continuity of interest *so far as the voting stock is concerned* remains whether some stockholder received an added dollar or not.[2]

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[2]The amount or percentage of cash added, so long as there is voting-stock participation in the new corporation in exchange for voting-stock participation in the old, is a false quantity so far as this problem is concerned. The percentage of interest itself can vary widely without destroying continuity. For example, a sole owner of a small corporation making a solely stock-for-stock exchange with a large corporation may wind up with only a 10% or 1% equity ownership in the large corporation (and through it, in the small corporation of which he formerly owned 100%), but the continuity of interest requirement is fully satisfied. If he receives in addition a dollar in cash, *the equity percentages remain exactly the same.* The percentages depend strictly upon (1) the percentage of the total voting stock transferred on the one hand (not less than 80%), and (2) the percentage of the total voting stock received on the other hand (any percentage). So, if Turnbow received 82,000 out of a total of 100,000 shares of Foremost, his equity ownership in Foremost (and through Foremost, in Supply) would end up at 82%, while if he received 82,000 out of a total of 1,000,000 shares of Foremost, his equity ownership in Foremost (and Supply) would end up at 8.2%—*both regardless of the amount of added cash which he might receive.* The Commissioner's sudden switch from consideration of the 80% minimum requirement on the one side to discussion of the 30-70 stock-

The Commissioner's inconsistency with admitted legislative policy stands out in sharp relief on comparing B-type reorganizations with mergers. In 1934 Congress determined that exchanges of at least 80% of the voting stock of one corporation solely for voting stock of another, or of substantially all the assets of one corporation solely for voting stock of another, represented sufficient continuity of interest to receive the same treatment as mergers or consolidations, and that such treatment was necessary in order not to have stockholders in some states suffer discrimination as compared with those in other states where such transactions would fit the local requirements of statutory mergers or consolidations (S. Rept. 558, 73d Cong., 2d Sess., 16-17 (C.B. 1939-1, Pt. 2, pp. 598-599, quoted, Petr. Br. 23). But Congress did not then change § 112(c)(1), which covered the tax treatment of boot. In mergers, the tax laws had long provided for tax deferment to the extent of like-for-like stock, and taxation of gain to the extent of boot if the exchange included money or other property. If in a state where the transaction would not qualify as a statutory merger a stockholder could not demand an extra dollar in cash and still be accorded tax deferment on any paper gain as far as the stock was concerned, while in another state a stockholder in a similar transaction would be accorded such treatment simply because

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cash ratio on the other side (Resp. Br. 44) must be read cautiously, for it leaps to a false issue.

It is to be ever remembered (1) that any gain is always currently taxable to the extent of the cash, and (2) that these various percentages can just as readily occur in a statutory merger or consolidation, with no different effect as to continuity of interest, tax deferment as to the stock, and current taxation of gain to the extent of the cash.

the transaction would meet the local statutory requirements of a merger, the objective of Congress to prevent such discrimination would pro tanto be defeated.

The necessity for such parity of tax treatment, and its harmony with the over-all legislative policies, clearly appear in the not uncommon situation presented in the *Howard* case, supra (238 F.2d 943). There, basically, was a B-type (voting-stock-for-voting-stock) reorganization, but some of the minority stockholders demanded cash—certainly not an uncommon situation. The court held the boot provision (§ 112(c)) applicable, thus satisfying all policies—deferring the tax to the extent of the like-for-like part of the transaction and limiting immediate taxation of gain to the amount of cash received.

Howard, we submit, is correct. It truly reflects the interrelation and fullest application of the Congressional purposes and policies and the statutes themselves.[3]

In net result, the Commissioner is arguing (as the court below held) that the boot provisions, while fully operative with respect to A-, D-, E- and F-type reorganizations, disappear from the legislative pattern when boot is added to what are basically (and but for the boot would be *wholly* tax deferred as) B- and C-type reorganizations. Elimination of B- and C-type reorganizations from the

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[3]The Commissioner's statement that the *Howard* decision "has been universally criticized" by tax commentators (Resp.Br. 19) is not accurate, as a reading of the cited comments readily reveals. A number of the "critical" comments were based on the startling and obviously erroneous premise that *Howard* decided that a B-type reorganization can include cash boot—e.g., Donnelly, Kanter, and 73 Harv.L.Rev. 1402 (Resp.Br. 19, note 4). By contrast, the note in 43 Va.L.Rev. 436 correctly analyzes the decision and suggests that it was logical and correct.

scope of the well-established legislative pattern would effect a deviation from the natural operation of demonstrated legislative policy with no discernible hint from Congress as to why this should be.

In the end, the Commissioner doubts his own argument. He is not sure but that a B- or C-type reorganization may qualify as such despite the inclusion of other property or money, and that the result reached by *Howard* is arguably correct (Resp.Br. 21, note 7; and again at page 41, note 15).

THIRD: THE COMMISSIONER'S INTERPRETATION OF § 112(c)(1) IS LOGICALLY AND GRAMMATICALLY FALLACIOUS. THE TAXPAYER'S READING IS LOGICALLY AND GRAMMATICALLY SOUND.

The essence of the Commissioner's contention is that from the reference in § 112(c)(1) to "property permitted, etc." it follows that Congress intended to write in a requirement that all prerequisites to nonrecognition must first be satisfied as to that property, having in mind the existence of boot as part of the exchange; then and only then can the "if not" supposition be applied—too late to accomplish hypothetical elimination of the boot.

Let us analyze this reasoning. Suppose one says: "If this creature would be a man if it were not for the fact that he has not only the characteristics of a male human being but also horns and a forked tail, he is a devil." The Commissioner's reasoning would be: "But this creature does have horns and a forked tail, which are not characteristics of a male human being; therefore the hypothesis does not apply, and he is not a devil." Such

reasoning is an obvious perversion of the plain intent of the supposititious sentence. Yet it is precisely the Commissioner's method in the present case.

Looking closely at the Commissioner's step-by-step reasoning reveals the precise point of fallacy. He says (Resp.Br. 17) "§ 112(c)(1) first divides the property received into two categories • • • and then provides that, if the exchange *'would be'* [our italics] within § 112(b)(3) if [etc.] • • • If that is a proper reading, the provision cannot apply unless *some* of the property received *in fact belongs* [our italics] to the first category." The switch is evident. The Commissioner has started from the statutory *contrary-to-fact* subjunctive, and restated it as *in-fact* present indicative. Here is the basic non sequitur, the precise point at which the Commissioner misreads the statutory language.

Logically and grammatically, the statute presents a contrary picture. Section 112(c)(1) in using the words "If an exchange would be • • • if it were not for" depicts a hypothesis contrary to fact. The presence of the cash *in fact* (in what otherwise would be B- and C-type reorganizations) spoils "solely for stock or securities" in § 112(b)(3) and "solely for • • • voting stock" as imported into § 112(b)(3) from § 112(g)(1)(B). The Commissioner says the "if not" supposition applies readily enough to restore (hypothetically) the first "solely," but then stops applying, short of restoring (hypothetically) the second "solely" and hence "reorganization." Nothing in the statute hints at this artificial demarcation.

Natural understanding of the language is all to the contrary. Congress first (§ 112(b)) described the exchange

transactions for which it provided total tax deferment. Then it considered in §§ 112(c)(1), (d) and (e) the same exchanges with other property or money added. There was no need to spell out once again all the specific exchanges plus boot. Instead, Congress used the simple device of a blanket reference to the kind of property as to which tax would be deferred, plus the supposition of other property or money added to it. The test which Congress set up by the "if not" clause was simply: "Absent the money or other property, would the remaining exchange be within the provisions for total tax deferment?"

This natural interpretation the Tax Court and its predecessor the Board of Tax Appeals have followed for many years without any division of opinion. Thus in the case at bar, the Tax Court, after noting the requirements of § 112(b)(3), including "solely," went on to say (R. 38-39):

> "Both of the sections involved here, subsection (b)(3) and subsection (c)(1), are provisions of long standing which were reenacted in the successive revenue acts which preceded the 1939 Code. In both the regulations of the Commissioner and in this Court's interpretation of section 112(c)(1), it has been understood that in order to give effect to the provisions of section 112(c)(1) the method to be followed is first to omit the item of cash (or other property) from the transaction and then to determine whether the exchange would be within subsection (b)(3). Otherwise, section 112(c)(1) would have no meaning in the context of its references to particular subsections of section 112(b).
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> In Luther Bonham, 33 B.T.A. 1100, 1103-4 (1936), this Court concluded that the method of applying the statute was as follows:

> • • • It is necessary therefore to determine whether or not the exchange of • • • stock for • • • stock would be within the provisions of subsection (b)(3) if the item of cash had been omitted and only • • • stock had been received in exchange for • • • stock. (Underscoring supplied.)"

The court then went on to quote from *Howard*, supra (which reversed the Tax Court on a point not reached by the latter), as follows:

> "Thus we may conclude that, in determining when these so-called 'boot' provisions apply, Congress intended that the transaction is to be considered separately and apart from the 'boot' received in determining whether it meets the nonrecognition provisions. If the transaction, absent from the 'other property or money,' fulfills the requirements of section 112(b)(3), then gain is to be recognized to the extent that 'boot' is received."

The Tax Court in the case at bar simply reiterated its understanding of many years as to the method of applying § 112(c)(1). In *Elizabeth Bruce* (1934) 30 B.T.A. 80 (later reversed on other grounds), and in *R. C. Love* (1939) 39 B.T.A. 172, the Board applied the method. In *Luther Bonham* (1936) 33 B.T.A. 1100, supra, the Board explained the application of § 112(c)(1) as plainly as words can express:

> "Giving careful consideration to the meaning of the term 'reorganization' quoted above from the statute and the facts in this case *after omitting from consideration, in accordance with the provisions of subsection (c) (1), the cash payment* received by the stockholders of the bank, we can find nothing of sub-

> stance which would distinguish this case from that of *Commissioner v. Watts*, 296 U. S. 387. Under authority of that decision, we accordingly hold that *but for the fact that cash was received* in the instant transaction, the exchange would be within subsection (b) (3) of section 112, *supra*, and under subsection (c) (1) of the same section the gain to the petitioner may not be recognized in an amount in excess of $67,500 [the amount of cash received]" (emphasis added).

Such was the Tax Court's reading of § 112(c)(1) for many years. Congress in 1934 did not change a word of § 112(c)(1), nor did it have occasion to in order to preserve its long-standing pattern of limited recognition of gain in boot situations.

This interpretative method of the Tax Court, repeated by unanimous decision over so long a period of years, is entitled to more than passing honor. This Court has observed that the Tax Court is an expert body, especially familiar with the interpretation and application of tax statutes, their background and legislative history, and the impact of its decisions upon both Treasury and taxpayer (*Dobson v. Commissioner* (1943) 320 U.S. 489, 498-502).

The 1934 amendment of the definition sections had no bearing upon this method of applying § 112(c)(1). What the amendment did was to tighten in certain particulars the definition of properties which the taxpayer could exchange without any recognition of gain (or loss) at the time. It did so by increasing to 80% the minimum stock to be transferred, and by excluding from nonrecognition securities other than voting stock through the addition of "solely." But it did not touch the boot provision, of

which the "if not" language was clearly understood to have the effect of overcoming the "solely" in § 112(b)(3) and in all natural contemplation would have the effect of following through and overcoming the effect of the "solely" now imported into § 112(b)(3) in its reference to "reorganization." The contention that Congress had something else in contemplation—though it left the boot provision just as it was—is unnatural, strained, and does not commend itself as a reasonable interpretation of the mind of Congress.

Section 112(c)(1) itself does not mention "reorganization." The reference to "reorganization" in the taxing statute is in § 112(b)(3), the description of what exchange of property can be made without any recognition of gain. When Congress changed "reorganization", it changed the category of property which can be exchanged without any recognition of gain; but it changed nothing about the boot provision, which continued to operate as before, taxing immediately the gain to the extent of all other components of the exchange.

In consequence of his unnatural approach, the Commissioner falls into sophistry. E.g., Brief for the Respondent, pages 29 et seq., where the Commissioner reasons, from the premise that §§ 112(b)(3) and (c)(1) apply only to individual exchanges, that any assumption permitted by § 112(c)(1) must be limited to an assumption about what was received by the single recipient in the particular exchange in issue. From this the Commissioner hypothesizes situations with absurd consequences, culminating in the Never-Never-Land of footnote 12 on page 32—as a final result of which he comes full-circle to the conclu-

sion that the assumption under § 112(c)(1) is not limited to what is received by the particular taxpayer but must take into account what is received in all the exchanges pursuant to the common plan.

The answer to all this is quite simple. If Turnbow, sole stockholder, receives only voting stock in the acquiring corporation, the exchange is exclusively like-for-like, the tax-deferment principle applies to the whole, and § 112(c)(1) does not come into the picture. If Turnbow, sole stockholder, receives voting stock plus cash, the exchange is partly like-for-like (to which the tax-deferment principle applies) and partly boot (to which immediate taxation of any gain applies). If there are multiple stockholders exchanging their stock pursuant to a common plan, stockholder X who receives only stock has all tax deferred, stockholder Y who receives stock plus cash pays taxes currently on any gain to the extent of the cash only, and stockholder Z who holds out for all cash pays taxes currently on his entire gain. The same result would obtain in a statutory merger. *Howard* is in accord.

The Commissioner's theory of reasoning from the premise that §§ 112(b)(3) and (c)(1) *apply* only to individual exchanges, that hence their applicability must be tested upon the particular exchange in issue (Resp.Br. 29), leads to obviously unintended consequences. For example, two stockholders each owning 40 per cent of the voting stock of a corporation to be acquired, together can make up the required 80 per cent. If they exchange their stock for voting stock of the acquiring corporation, there is a B-type reorganization. But if, in testing the applicability of § 112(b)(3) to one of the stockholders, we

must look only at the components of *his* exchange, then § 112(b)(3) cannot apply because that exchange involved only 40 per cent, not 80 per cent, of the voting stock of the acquired corporation and no tax deferment would result.

This illustrates that in determining the tax consequences to the individual, tax deferment and/or current taxation accompany, respectively, the stock and/or money or other property which *he* receives; but in determining the application of the deferment provisions (§§ 112(b)(3) and 112(c)(1)) to the corporate transaction in general, the entire transaction pursuant to the plan is the focal point. This presents no problem of either interpretation or administration; it accords with the declared intent of Congress; and it gives rise to none of the peculiar consequences envisioned by the Commissioner at pages 30-32 of his brief.

FOURTH: GIVING FULL CONSIDERATION TO ALL OF THE LEGISLATIVE HISTORY RELIED UPON, THE HISTORY FULLY SUPPORTS THE TAXPAYER'S LITERAL READING AND APPLICATION OF THE STATUTE.

Nowhere does the Commissioner's failure to regard the basic purposes and intent of Congress stand out more significantly than in his review of the legislative changes from 1921 to 1934 (Resp.Br. 55-65). He argues, in essence, that the addition of the "but for" language in 1924 made no substantive change, and could not have anticipated the narrowing of the reorganization definitions in 1934. But consider what Congress was trying to accomplish under the various acts and how it did so:

In 1921, when the stockholder-taxpayer in one of these corporate re-formations (merger, consolidation, reorganization) received stock or securities, no gain was recognized; when he received in addition money or other property, even though gain resulted he could apply the money to reduce his tax basis and defer his taxes to that extent (Revenue Act of 1921, § 202(c), 42 Stat. 230).

In 1923, if the stockholder-taxpayer received only stock or securities, again no gain was recognized; if he received in addition money or other property, his gain was currently taxed to the extent of the money or other property (removing the privilege of applying this to reduce his tax basis instead) (Act of March 4, 1923, 42 Stat. 1560).

In 1924, when Congress wrote "solely" into § 112(b)(3) (total tax deferment) § 112(c)(1) was reworded to preserve the pattern. The hypothetical form of § 112(c)(1) served to remove the exclusionary effect of "solely" in § 112(b)(3). Congress still deferred taxes as to the stock or securities, and currently taxed the gain to the extent of any money or other property (Revenue Act of 1924, § 203(d)(1), 43 Stat. 257).

By 1934, Congress was disturbed by the fact that taxpayers under existing law were able to exchange common stock (an equity interest) in one corporation for, say, callable preferred stock (easily convertible to cash) or even a predominant amount of debentures (a creditor interest, almost the equivalent of cash) in another corporation and obtain tax deferment, since these were "securities" within § 112(b)(3). (If any cash were added, of course the boot provision took care of that by exclud-

ing it from nonrecognition of gain.) Such exchanges, Congress felt, were not sufficiently like-for-like exchanges —not sufficiently reflecting a continuity of interest—to merit treatment apart from the immediate taxation of gain in ordinary exchanges; i.e., they were really tax avoidance schemes having no economic justification. Congress set about eliminating them. But there was no concern and no reason for any concern over tax avoidance as to cash boot; § 112(c)(1) took care of that with current taxation of any gain to the extent of the boot received.

The House recommended withdrawing tax deferment from B- and C-type reorganizations entirely (H.Rept. 704, 73d Cong., 2d Sess., 12-14 (C.B. 1939-1, Pt. 2, 563-565)); but the Senate (and the Congress finally) decided that this would unduly interfere with legitimate business adjustments, and that changing the "stock or securities" requirement to "voting stock" and lifting the minimum of exchanged stock from a bare majority to 80 per cent would reinforce the continuity-of-interest factor and prevent the tax avoidance schemes.[4] *But Congress did not touch or even mention § 112(c)(1),[5] and the "other property or money" feature was no part of its concern about tax avoidance because any gain to that extent was always currently taxable since 1923.* What Congress did was to define more narrowly the like-for-like element as to which taxation was to remain on a deferred basis, but it had no occasion to, and did not, bother about the tax treatment of boot added to the like-for-like property.

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[4]S.Rept. 558, 73d Cong., 2d Sess., 16-17 (C.B. 1939-1, Pt. 2, 598-599), quoted in our opening brief, pages 23, 25.

[5]Congress was not unmindful of § 112(c) in 1934; it made a technical amendment of § 112(c)(2) (48 Stat. 704).

Congress had experienced the manner in which § 112(c)(1) hypothetically removed the exclusionary effect of "solely" in § 112(b)(3). So when Congress inserted "solely" in § 112(g)(1)(B)—incorporated by reference into § 112(b)(3)—it was only natural to expect that § 112(c)(1) would continue to take care of boot-added situations by hypothetically removing the effect of "solely" throughout.[6] Far more readily is this to be expected than that Congress would think it was covertly removing two ordinary types of corporate re-formations from the scope of the well-known boot-added pattern without mention of the fact, contrary to its expressed purpose of interstate uniformity with mergers and consolidations, and particularly when so doing would correspondingly remove them from the purview of § 112(e) and create a wide-open loophole for turning paper losses into tax losses, which Congress had worked so purposefully to avoid.

This is where the Commissioner's brief neglects the significant piece of legislative history which proclaims a purpose diametrically opposed to his theory. In rejecting the House's recommendation to drop B- and C-type reorganizations from the definitions in 1934, the Senate Committee report which accompanied the legislation in its final form stated that exchanges of 80 per cent of the voting stock on the one hand solely for voting stock on the other were sufficiently similar to statutory mergers and

[6]It is of interest that the Conference Committee Report (H. Rept. 1385, 73d Cong., 2d Sess., 21-22 (C.B. 1939-1, Pt. 2, 632)) discussed the amendment of § 112(g)(1) in the language of "all or part of the voting stock" without even mentioning "solely." The word could not have been thought to make a significant change in the existing tax pattern.

consolidations as to be entitled to similar tax treatment, and should be permitted "in order to bring about a more uniform application of the provisions in all 48 of the States."[7] Whereas in statutory mergers and consolidations, cash could be (and frequently is) added to the stock consideration, and tax deferment applies to the extent of the value of the stock received while gain to the extent of the cash is immediately taxed, uniformity will not follow if in another state an identical transaction not constituting a statutory merger under local law receives not even partial tax deferment. The positive intention of Congress to provide for equal and uniform tax treatment confirms the literal reading of § 112(c)(1) and belies the Commissioner's distortion of it.

Likewise, the Commissioner's brief neglects the committee report accompanying the Hendler amendment in 1939 (quoted, Petr.Br. 25-26), which provides, in effect: If under the specifically defined circumstances, the taxpayer transfers property and receives in exchange stock or securities in a corporation which is a party to the reorganization, nonrecognition of the entire gain is allowed; but if other property or money is added, gain is recognized to the extent of such other property or money.

In another aspect, the Commissioner's theory does even more obvious violence to the legislative history. This is with respect to § 112(e), dealing with losses. It is undenied that § 112(e) and its predecessors were enacted for the express purpose of preventing loss-taking through the device of inserting some cash or other property into what

[7] S.Rept. 558, 73d Cong., 2d Sess., 16-17, supra (C.B. 1939-1, Pt. 2, pp. 598-599), quoted in our opening brief, page 23.

was basically an exchange of like-for-like interests.[8] But, now says the Commissioner in effect, in 1934 Congress intended by amending §§ 112(g)(1)(B) and (C) to remove these classes of transactions from the application of the "if not" language in the boot provisions, with the consequence of opening up a large loophole for the taking of tax losses through the same simple device. Not only did Congress give no hint that such was its desire; on the contrary, the committee reports at the time are filled with expressions of Congressional purpose to eliminate the taking of the losses while the taxpayers retain an interest in the corporation.[9]

The taxpayer's reading of the statutes accords with the expressed legislative purposes; the Commissioner's reading is at war with them.

FIFTH: THE COMMISSIONER'S ARGUMENT REGARDING "BASIS" IS UNSOUND; TAX TIMING AND BASIS ARE NOT INTERDEPENDENT. EVEN A QUALIFYING REORGANIZATION CAN RECEIVE A STEPPED-UP BASIS.

The Commissioner's thesis here is that a "carryover" basis for the acquiring corporation must exist only where nonrecognition of gain (tax deferment) to the stockholder exists (Resp.Br. 53). Such, however, is not the law and

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[8]The legislative history in this connection is reviewed in the *Howard* case, with particular reference to the explanatory committee report (quoted in our opening brief, pages 15-16).

[9]Both the House (H.Rept. 704, 73d Cong., 2d Sess., 12-14, C.B. 1939-1, Pt. 2, 563-565) and the Senate (S.Rept. 558, 73d Cong., 2d Sess., 17, C.B. 1939-1, Pt. 2, 599, quoted in our opening brief, page 25) acted on committee reports strongly recording a purpose to prevent such loss-taking.

the Commissioner has so conceded. In *Firestone Tire & Rubber Co.* (1943) 2 T.C. 827, the Tax Court held that in a qualified B-type reorganization where the acquiring corporation utilized its treasury shares in the exchange, it would receive a stepped-up basis—i.e., the cost of its treasury shares—despite the fact that any gain to the stockholder would admittedly not be recognized and tax deferment would result as to him. The Commissioner first indicated nonacquiescence (C.B. 1944, 38), then dismissed his appeal and registered acquiescence with the Tax Court's decision (C.B. 1945, 3). This was acquiescence that recognition of gain to the stockholders is not wedded to the corporation's basis, despite the Commissioner's present argument to the contrary.

The Commissioner's "related point" (Resp.Br. 53) is likewise unsound. Our interpretation, he argues, would deprive the solely-for-voting-stock limitation in § 112(g)-(1)(B) of any rational purpose at all. On the contrary, the solely-for-voting-stock limitation had a direct, obvious and wholly rational effect on § 112(b)(3); where previously total nonrecognition could follow an exchange of nonvoting stock, the narrower definition of a B-type reorganization precluded that effect. The Commissioner admits (Resp.Br. 54) that if Congress had not put the limitation into § 112(g)(1)(B), it would have had to do something with § 112(b)(3) to achieve its purpose; and this would have been considerably more awkward in view of the more general application of § 112(b)(3).

SIXTH: THE REGULATIONS SUPPORT THE TAX COURT'S INTERPRETATION, NOT THAT PRESENTLY ADVOCATED BY THE COMMISSIONER.

The Tax Court in the case at bar pointed out (R. 40-41) that the regulations remained unchanged throughout the long period during which the Tax Court continuously interpreted § 112(c)(1) as requiring first the hypothetical omission of the boot from the transaction and thereupon the testing of the transaction without boot against the requirements of § 112(b)(3). Without change, the regulations followed and accepted the *Bonham* decision from 1936 on. As the Tax Court said (R. 41):

> "Thus, there has been a long-standing and continuous construction of section 112(c)(1) (and the corresponding section in the earlier revenue acts) which has remained unchanged over the years in the face of the several reenactments of the statutory provision, as well as the amendment in the 1934 Act of section 112(g)(1)(B), when there was introduced into subsection (g)(1)(B) the word, 'solely,' in harmony with the provisions of subsections (b)(2), (b)(3), (b)(4), and (b)(5) which also contained the word, 'solely,' and contained 'solely' for many years. The respondent's regulations, therefore, are deemed to have received the approval of Congress. Helvering v. Winmill, 305 U.S. 79; Lykes v. United States, 343 U.S. 118. Respondent has not offered any explanation for his departure in this case from his long-standing interpretation of section 112(c)(1) set forth in his regulations."

Failure to change the regulations while the Tax Court was continuously interpreting § 112(c)(1) as it did is strong indication that the regulations accorded with the

Tax Court's view—as the Tax Court itself found (R. 41-42).

The Commissioner's brief does not refer to all of the applicable regulations.[10] It omits all reference to the basic regulation dealing with the receipt of boot: Regulations 118, § 39.112(c)-1 (quoted in our opening brief, Appx. viii-ix), which provides:

> "§ 39.112(c)-1 *Receipt of other property or money in tax-free exchange not connected with corporate reorganization.* (a) If in any transaction in which property held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment; • • • [certain specific provisions inapplicable here] • • • there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then
>
> (1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but
>
> (2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e))."

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[10]He quotes a part of a section dealing with a specific situation (Resp.Br. 65-66) saying:

> "That regulation, it may be seen, is a restatement of § 112 (b)(3) and § 112(c)(1) read together. It puts them together in such a way, however, as to eliminate the 'but for' reference . . . ."

Though appropriate to the specific situation which it described, this regulation cannot "eliminate" the "but for" reference in the statute wherever that is applicable. Any regulation which conflicts with the plain words of the statute of Congress is invalid (*Helvering v. Sabine Trans. Co.* (1943) 318 U.S. 306, 311-312).

The basic regulation repeats the fundamental tax pattern and by its terms covers the transaction at bar. It was not changed throughout the period of the Tax Court's "long-standing and continuous construction of section 112(c)(1)." The Tax Court's determination that the method of applying § 112(c)(1) is in accord with the Commissioner's long-standing regulations is correct.

CONCLUSION

There is no merit, either logical, economic or historical, in the contentions advanced in the Commissioner's brief. We respectfully submit that the judgment of the court below should be reversed.

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FRANCIS R. KIRKHAM,
HARRY R. HORROW,
FRANCIS N. MARSHALL,
WHITCOMB J. MCFARLAND,
Attorneys for Petitioners.

PILLSBURY, MADISON & SUTRO,
STACY H. DOBRZENSKY,
Of Counsel.